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Office of the Assistant Secretary for Housing-Federal Housing Commissioner; HUD's Regulation of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac); Proposed Rule

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of the Assistant Secretary for Housing—Federal Housing Commissioner

24 CFR Part 81

[Docket No. FR–4494–P–01]

RIN 2501–AC60

HUD's Regulation of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac)

AGENCY: Office of the Assistant Secretary for Housing-Federal Housing Commissioner, HUD.

ACTION: Proposed rule.

SUMMARY: Through this proposed rule, the Department of Housing and Urban Development is soliciting comments on proposed new housing goal levels for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, the Government Sponsored Enterprises, or GSEs) for calendar years 2000 through 2003. In accordance with the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, this rule proposes new goal levels for the purchase by Fannie Mae and Freddie Mac of mortgages financing low-and moderate-income housing, special affordable housing, and housing in central cities, rural areas, and other underserved areas. This rule also proposes to clarify HUD's guidelines for counting different types of mortgage purchases toward those goals, and to provide greater public access to certain types of mortgage data on the GSEs' mortgage purchases in HUD's public use database. This rule also solicits public comments on several other issues related to the housing goals.

While Fannie Mae and Freddie Mac have been successful in providing stability and liquidity in the market for certain types of mortgages, their share of the affordable housing market is substantially smaller than their share of the total conventional conforming mortgage market. There are several reasons for these disparities, related both to the GSEs' purchase and underwriting guidelines and to their relatively low level of activity in specific markets that serve lower-income families, including small multifamily rental properties, manufactured housing, single family owner-occupied rental properties, and seasoned affordable housing mortgages. As the GSEs continue to grow their businesses, the proposed new goals will provide strong incentives for the two enterprises to more fully address the housing finance needs for very low-, low-and moderate-income families and residents of underserved areas and thus, more fully realize their public purposes.

DATES: Comments must be submitted on or before: May 8, 2000.

ADDRESSES: Interested persons are invited to submit written comments regarding this proposed rule to the Regulations Division, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410. Written comments may also be provided electronically to the following e-mail address: hsg-gse@hud.gov All communications should refer to the above docket number and title. Facsimile (FAX) comments are *not* acceptable. A copy of each communication submitted will be available for public inspection and copying between 7:30 a.m. and 5:30 p.m. weekdays at the above address.

FOR FURTHER INFORMATION CONTACT: Janet A. Tasker, Director, Office of Government Sponsored Enterprises Oversight, Room 6182, telephone (202) 708–2224. For questions on data or methodology, contact John L. Gardner, Director, Financial Institutions Regulation Division, Office of Policy Development and Research, Room 8234, telephone (202) 708–1464. For legal questions, contact Kenneth A. Markison, Assistant General Counsel for Government Sponsored Enterprises/ RESPA, Office of the General Counsel, Room 9262, telephone (202) 708–3137. The address for all of these persons is: Department of Housing and Urban Development, 451 Seventh Street, SW, Washington, DC 20410.

Persons with hearing and speech impairments may access the phone numbers via TTY by calling the Federal Information Relay Service at (800) 877–8399.

SUPPLEMENTARY INFORMATION:

I. General

A. Purpose

Through this proposed rule, the Department of Housing and Urban Development (HUD or the Department) is soliciting comments on proposed new housing goal levels for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) (collectively, the Government Sponsored Enterprises, or GSEs) for calendar years 2000 through 2003. The housing goals will be phased in beginning in calendar year 2000 and will be fully implemented by calendar year 2001. In accordance with the Federal Housing Enterprises Financial Safety and Soundness Act of 1992,[1] which requires the GSEs to facilitate the financing of affordable housing for low- and moderate-income families and underserved neighborhoods and requires the Department to establish housing goals; this rule proposes increased housing goal levels for the purchase by Fannie Mae and Freddie Mac of mortgages financing low- and moderate-income housing, special affordable housing, and housing in central cities, rural areas, and other underserved areas. This rule also proposes to clarify HUD's guidelines for counting different types of mortgage purchases toward those goals, and to provide greater public access to certain types of mortgage data on the GSEs' mortgage purchases in HUD's public use database. This rule also solicits public comments on several other issues related to the housing goals.

While Fannie Mae and Freddie Mac have been successful in providing stability and liquidity in the market for certain types of mortgages, their share of the affordable housing market is substantially smaller than their share of the total conventional conforming mortgage market. The GSEs' mortgage purchases accounted for 39 percent of all owner and rental housing units that were financed in the market during 1997, but their purchases that qualified for the Low- and Moderate-Income Housing Goal represented only 30 percent of the low- and moderate-income housing market and their Special Affordable Housing Goal (directed toward very low- and low-income families) qualifying mortgage purchases represented only 24 percent of that market. There are several reasons for these disparities, related both to the GSEs' purchase and underwriting guidelines and to their relatively low level of activity in specific markets that serve lower-income families, including small multifamily rental properties, manufactured housing, single family owner-occupied rental properties, and seasoned affordable housing mortgages. As the GSEs continue to grow their businesses, the proposed new goals will provide strong incentives for the two enterprises to more fully address the housing finance needs of very low-, low- and moderate-income families and the residents of underserved areas, and,

[1] 12 U.S.C. 4501 et seq.; Pub. L. 102–550, approved Oct. 28, 1992.

thus, more fully realize their public purposes.

In determining the appropriate level of the housing goals, HUD must consider six statutory factors: national housing needs; economic, housing and demographic conditions; performance and effort of Fannie Mae and Freddie Mac toward achieving the housing goals in previous years; the size of the conventional mortgage market serving the targeted population or areas relative to the size of the overall conventional mortgage market; the ability of the GSEs to lead the industry in making mortgage credit available for the targeted population or areas; and the need to maintain the sound financial condition of the GSEs.

Based on consideration of all the statutory factors, HUD is proposing increases to the housing goal levels. In summary, the shares of the mortgage markets that qualify for each of the housing goals are higher than the current goal levels. The proposed goal levels will close the gap between the GSEs' performance and the opportunities available in the primary mortgage market. The proposed goal levels, while consistent with the Department's estimate of the market share for each goal, are higher than the GSEs' current level of performance, yet they would be reasonable even under economic conditions more adverse than have existed recently. There are a number of relatively untapped segments of the multifamily, single family owner-occupied, and single family rental markets where the GSEs might play an enhanced role and thereby increase their shares of targeted loans and their performance on the housing goals. These areas include small multifamily mortgage loans, multifamily rehabilitation loans, single family rental property loans, manufactured housing loans, A-minus mortgage loans, and affordable seasoned loan purchases. The proposed goal levels will challenge both Fannie Mae and Freddie Mac to increase their purchases of mortgages for lower-income families and for properties in underserved areas, and to further their efforts to meet the affordable housing needs of lower-income families, minorities, and residents of underserved areas, who continue to face problems obtaining mortgage credit and who would benefit from a more active and focused secondary market. The Department's analyses indicate that there are substantial opportunities in the mortgage market where the GSEs may purchase additional mortgages that qualify for one or more of the housing goals. The GSEs have the financial and operational capacity to improve their affordable housing performance and lead the industry in supporting mortgage lending for families and neighborhoods targeted by the housing goals. Further, the GSEs themselves have indicated that they want to increase their market presence in many of the business areas identified above.

The current housing goal levels are 42 percent for the Low- and Moderate-Income Housing Goal, 24 percent for the Geographically Targeted Goal, and 14 percent for the Special Affordable Housing Goal. The Special Affordable Housing Goal includes a subgoal for mortgage purchases financing dwelling units in multifamily housing which is 0.8 percent of the dollar volume of mortgages purchased by the respective GSE in 1994—$1.29 billion annually for Fannie Mae and $988 million annually for Freddie Mac. The Department is proposing to increase the housing goal levels as follows: The proposed level of the Low- and Moderate-Income Housing Goal is 48 percent for calendar year 2000 and 50 percent in calendar years 2001–2003; the proposed level of the Geographically Targeted Goal is 29 percent for calendar year 2000 and 31 percent in calendar years 2001–2003; and the proposed level of the Special Affordable Housing Goal is 18 percent in calendar year 2000 and 20 percent in calendar years 2001–2003. In addition, HUD is proposing to increase the special affordable multifamily subgoal to 0.9 percent of the dollar volume of total 1998 mortgage purchases in calendar year 2000 and to 1.0 percent in calendar years 2001–2003.

Further discussion of the statutory factors HUD is required to consider in setting the housing goals, and the rationale for HUD's establishment of these goals, are provided throughout the remainder of this preamble and in the Appendices to the Proposed Rule. In particular, because of the importance of the GSEs' ability to lead the industry in making mortgage credit available for targeted populations and areas, HUD is seeking comment on the following: Are the proposed housing goals appropriate given the statutory factors HUD must consider in setting the goals, and in light of the market estimates of the GSEs' shares of the affordable housing market? (See Section E.7, ''Closing the Gap Between the GSEs and The Market.'').

B. Background

1. *Fannie Mae and Freddie Mac.* The GSEs engage in two principal businesses: investing in residential mortgages and guaranteeing securities backed by residential mortgages. Fannie Mae and Freddie Mac are Government Sponsored Enterprises, chartered by Congress in order to: (1) Provide stability in the secondary market for residential mortgages; (2) respond appropriately to the private capital market; (3) provide ongoing assistance to the secondary market for residential mortgages (including activities relating to mortgages on housing for low-and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing; and (4) promote access to mortgage credit throughout the nation (including central cities, rural areas, and other underserved areas) by increasing the liquidity of mortgage investments and improving the distribution of investment capital available for residential mortgage financing.[2]

Fannie Mae and Freddie Mac receive significant explicit benefits through their status as GSEs that are not enjoyed by any other shareholder-owned corporations in the mortgage market. These benefits include: (1) Conditional access to a $2.25 billion line of credit from the U.S. Treasury;[3] (2) exemption from the securities registration requirements of the Securities and Exchange Commission and the States;[4] and (3) exemption from all State and local taxes except property taxes.[5]

Additionally, although the securities the GSEs guarantee and the debt instruments they issue are not backed by the full faith and credit of the United States, and nothing in this proposed rule should be construed otherwise, the GSEs' securities trade at yields only a few basis points over those of U.S. Treasury securities and at yields lower than those received for securities issued by potentially higher-capitalized, fully private, but otherwise comparable firms. The market prices for GSE debt and mortgage-backed securities, and the fact that the market does not require that those securities be rated by a national rating agency, suggest that investors perceive that the government implicitly backs the GSEs' debt and securities. This perception evidently arises from the GSEs' relationship to the Federal

[2] See sec. 301 of the Federal National Mortgage Association Charter Act (Fannie Mae Charter Act) (12 U.S.C. 1716); sec. 301(b) of the Federal Home Loan Mortgage Corporation Act (Freddie Mac Act) (12 U.S.C. 1451 note).

[3] Secs. 306(c)(2) of the Freddie Mac Act and 304(c) of the Fannie Mae Charter Act.

[4] Secs. 306(g) of the Freddie Mac Act and 304(d) of the Fannie Mae Charter Act.

[5] Secs. 303(e) of the Freddie Mac Act and 309(c)(2) of the Fannie Mae Charter Act.

Government, including their public purposes, their Congressional charters, their potential direct access to U.S. Department of Treasury funds, and the statutory exemptions of their debt and mortgage-backed securities (MBS) from otherwise mandatory security laws. Consequently, each GSE's cost of doing business is significantly less than that of other firms in the mortgage market. According to the U.S. Department of Treasury, the benefits of federal sponsorship are worth almost $6 billion annually to Fannie Mae and Freddie Mac. Of this amount, reduced operating costs (*i.e.,* exemption from SEC filing fees and from state and local income taxes) represent approximately $500 million annually. These estimates are broadly consistent with the magnitudes estimated by the Congressional Budget Office and General Accounting Office. Fannie Mae and Freddie Mac appear to pass through part of these benefits to consumers through reduced mortgage costs and retain part for their own stockholders.[6]

2. Regulation of the GSEs—FHEFSSA. In 1968, Congress assigned HUD general regulatory authority over Fannie Mae [7] and in 1989, Congress granted the Department essentially identical regulatory authority over Freddie Mac.[8] Under the 1968 and 1989 legislation, HUD was authorized to require that a portion of Fannie Mae's mortgage purchases be related to the national goal of providing adequate housing for low- and moderate-income families. Accordingly, the Department established two housing goals—a goal for low-and moderate-income housing and a goal for housing located in central cities—by regulation, for Fannie Mae in 1978.[9] Each goal was established at the level of 30 percent of mortgage purchases. Similar housing goals for Freddie Mac were proposed by the Department in 1991 but were not finalized before October 1992, when Congress revised the Department's GSE regulatory authorities including requirements for new housing goals.

In 1992, Congress enacted the Federal Housing Enterprises Financial Safety and Soundness Act (FHEFSSA),[10] which revamped the statutory requirements and regulatory structure of the GSEs by separating the Government's financial regulation of the GSEs from its mission regulation. FHEFSSA created a new Office of Federal Housing Enterprise Oversight (OFHEO), within HUD, which was assigned new, independent, regulatory powers to ensure the GSEs' financial safety and soundness.[11] At the same time, FHEFSSA affirmed the Secretary of Housing and Urban Development's responsibility for mission regulation and provided that, except for the specific authority of the Director of OFHEO relating to the safety and soundness of the GSEs, the Secretary retains general regulatory power over the GSEs.[12] FHEFSSA also detailed and expanded the Department's specific powers and authorities, including the power to establish, monitor, and enforce housing goals for the GSEs' purchases of mortgages that finance housing for low- and moderate-income families, housing located in central cities, rural areas, and other underserved areas, and special affordable housing, affordable to very low-income families and low-income families in low-income areas.[13]

FHEFSSA also required that the Department prohibit the GSEs from discriminating in their mortgage purchases and charged the Department with several fair lending authorities including the power to take remedial action against lenders found to have engaged in discriminatory lending practices and to periodically review and comment on the GSEs' underwriting and appraisal guidelines to ensure that such guidelines are consistent with the Fair Housing Act and the fair housing requirements in FHEFSSA.[14]

FHEFSSA affirmed and detailed HUD's authority to review and approve new programs of the GSEs [15] and to require reports from the GSEs [16] including periodic data and information submissions.[17] FHEFSSA also required that the Department establish a public use data base and implement requirements for the protection of proprietary information provided by the GSEs.[18] FHEFSSA also contained detailed procedural requirements for the exercise of HUD's regulatory authorities.[19]

FHEFSSA provided that performance under its income based housing goals—the low- and moderate-income and special affordable housing goals—would be counted based on the actual income of owners and renters. The earlier housing goal regulations governing Fannie Mae had counted performance under the then existing low- and moderate-income housing goal based on house prices and rent levels.[20] The previous central cities goal counted Fannie Mae's mortgage purchases in areas designated by the Office of Management and Budget (OMB) as central cities. Following a two year transition, FHEFSSA expanded the central cities goal to include rural and other underserved areas (see discussion below). Under FHEFSSA, the Department is required to establish each of the goals after consideration of certain prescribed factors relevant to the particular goal.[21]

3. *Transition Period.* For a transition period of calendar years 1993 and 1994, FHEFSSA established statutory targets for purchases by Fannie Mae and Freddie Mac of mortgages on housing for low- and moderate-income families and housing located in OMB-defined central cities; and mortgages on special affordable housing.[22] FHEFSSA's targets for (a) low- and moderate-income mortgage purchases; and (b) central cities mortgage purchases were each established at the pre-FHEFSSA goal level of at least 30 percent of the units financed by each GSEs' total mortgage purchases for those years.[23] FHEFSSA's targets for the Special Affordable Housing Goal for the transition years,[24] unlike the other targets, were set at no less than a minimum amount of mortgage purchases measured in dollars financed, rather than the percentage of units, with the Fannie Mae goal greater than the Freddie Mac goal. For the transition period, FHEFSSA also set subgoals under the Special Affordable

[6] U.S. Department of Treasury, *Government Sponsorship of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation*(1996), page 3.

[7] Section 802(ee) of the Housing and Urban Development Act of 1968 (Pub. L. 90–448, approved August 1, 1968; 82 Stat. 476, 541).

[8] See sec. 731 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) (Pub. L. 101–73, approved August 9, 1989), which amended the Freddie Mac Act.

[9] See 24 CFR 81.16(d) and 81.17 (1992 codification).

[10] Pub. L. 102–550; approved Oct. 28, 1992.

[11] Sec. 1311 of FHEFSSA; see also sec. 1313 of FHEFSSA. FHEFSSA charged OFHEO with designing and administering a stress test for capital adequacy and risk-based capital standards to ensure the financial safety and soundness of the GSEs. The proposed rule containing the risk-based capital requirements was published by OFHEO in the **Federal Register** (Vol. 64, No. 70) on April 13, 1999. Hereafter, unless otherwise specified, all section citations are citations to the Federal Housing Enterprises Financial Safety and Soundness Act of 1992.

[12] Sec. 1321.

[13] See generally secs. 1331–34.

[14] Sec. 1325(1)–(6).

[15] Sec. 1322.

[16] Sec 1327.

[17] See secs. 1381(o)–(p), 1382(r)–(s).

[18] Secs. 1323, 1326.

[19] Secs. 1322, 1336, and 1341–49.

[20] 24 CFR 81.2(1)(3) (1992 codification). Under the previous regulations, "housing for low- and moderate-income families" included "any single family dwelling * * * purchased at a price not in excess of 2.5 times the median family income * * * for the Standard Metropolitan Statistical Area."

[21] Secs. 1332(b), 1333(a)(2), 1334(b).

[22] Secs. 1332(d), 1333(d), and 1334(d).

[23] Secs. 1332(d)(1) and 1334(d)(1).

[24] Sec. 1333(d)(1) and (2).

Housing Goal for purchases of single family and multifamily mortgages.

FHEFSSA required HUD to establish interim goals for the transition period to improve the GSEs' performances relative to the statutory targets for low- and moderate-income and central cities mortgage purchases so that the GSEs would meet the targets by the end of the transition period.[25] Following the transition, the Department would establish the goals under the statutory factors and FHEFSSA required the Department to establish a broader underserved areas goal inclusive of rural and other underserved areas as well as central cities to be defined by HUD.

On October 13, 1993, HUD published notices in the **Federal Register** establishing the interim goals and subgoals for the GSEs' mortgage purchases, and requirements for implementing those goals.[26] For Fannie Mae, HUD set the interim goal for housing for low- and moderate-income families at 30 percent of the units financed by mortgage purchases for 1993 and 1994;[27] for housing located in central cities at 28 percent for 1993 and 30 percent for 1994;[28] and for special affordable housing at $16.4 billion over the 1993–94 transition period.[29] For Freddie Mac, HUD set the interim goal for housing for low- and moderate-income families at 28 percent of the units financed by mortgage purchases for 1993 and 30 percent for 1994;[30] the interim goal for housing located in central cities at 26 percent for 1993 and 30 percent for 1994;[31] and for special affordable housing at $11.9 billion over the 1993–94 transition period.[32] On November 30, 1994,[33] HUD extended the 1994 goals for both GSEs through 1995 while the Department completed its development of post transition goals.

[25] Secs. 1332(d)(2)(A) and 1334(d)(2)(A).

[26] 58 FR 53048, 53072.

[27] 58 FR 53049.

[28] *Id.*

[29] HUD arrived at this amount of $16.4 billion by doubling Fannie Mae's good faith estimate of its mortgage purchases that would have qualified for the Special Affordable Housing Goal in 1992 (*i.e.,* $5.85 billion in single family mortgage purchases and $1.34 billion in multifamily mortgage purchases), and adding the $2 billion increment specified in section 1333(d)(1) of FHEFSSA. See 58 FR 53049.

[30] 58 FR 53072.

[31] *Id.* at 53073.

[32] HUD arrived at this amount of $11.9 billion by doubling Freddie Mac's good faith estimate of its mortgage purchases that would have qualified for the Special Affordable Housing Goal in 1992 (*i.e.,* $5.19 billion in single family mortgage purchases and $0.02 billion in multifamily mortgage purchases), and adding the $1.5 billion increment specified in section 1333(d)(2) of FHEFSSA. See 58 FR 53073.

[33] 59 FR 61504.

Both GSEs surpassed their goals for low- and moderate-income housing in 1993, 1994, and 1995. Neither GSE met its central cities goal in 1993; while Fannie Mae successfully met its central cities goal for 1994 and 1995, Freddie Mac never achieved its central cities goal during the transition period from 1993 through 1995. Both GSEs exceeded their respective special affordable housing goals and their respective single family subgoals. Fannie Mae also exceeded its multifamily subgoals for the transition period. Although Freddie Mac did not achieve the multifamily subgoal during the 1993 through 1994 period, Freddie Mac's multifamily purchases increased every year during the transition period such that Freddie Mac did achieve its multifamily subgoal in 1995.

4. HUD's 1995 Rulemaking. The Department issued proposed and final rules in 1995 to establish and implement the housing goals for the years 1996 through 1999, and to implement the Department's other authorities in FHEFSSA.[34] These regulations replaced HUD's previous regulations governing Fannie Mae, and for the first time established regulations governing Freddie Mac. HUD benefited from substantial comment during the rulemaking process from the public, the GSEs, and representatives of lenders, developers, nonprofit groups, public interest organizations, other Federal agencies and academic experts. Through the 1995 rulemaking, HUD established counting requirements for the goals, revised and streamlined the special affordable housing goal, and redefined the central cities goal to target those geographic areas of central cities, rural areas, and other areas that are underserved by mortgage credit, including those areas—metropolitan and non-metropolitan—with low median incomes and/or high minority populations that typically experience the highest mortgage denial rates and the lowest mortgage origination rates. The new regulations also prohibit the GSEs from discriminating in their mortgage purchases, implement procedures by which HUD exercises its authority to review new programs of the GSEs, require reports from the GSEs, operate a public use data base on the GSEs' mortgage purchase activities while protecting confidential and proprietary information, and enforce HUD's authorities under FHEFSSA.

In setting the first, post-transitional period housing goals for the years 1996 through 1999, HUD sought to recognize the unique position the GSEs occupy in the nation's housing finance system and to ensure that, consistent with their Congressional mandates, the GSEs provide leadership in expanding housing opportunities and providing wider access to mortgage credit. In establishing each of the housing goals, HUD considered the factors presented in FHEFSSA, including national housing needs; economic, housing, and demographic conditions; the previous performance and effort of the GSEs in achieving the specific goal; the size of the primary mortgage market for that goal; the ability of the GSEs to lead the industry; and the need to maintain the sound financial condition of the GSEs.[35] HUD established the goals under the factors, based on its estimates of the market share at that time, at levels that were reasonable and appropriate, reflecting a margin to compensate for the cyclical nature of mortgage markets and the unpredictability of other economic indicators, and allowing the GSEs flexibility in choosing how to achieve the goals.[36] Recognizing the GSEs' and others concerns about need for predictability in order to manage their business operations, HUD established the levels of the goals for a four-year period. The rule provides that the housing goals for 1999 may continue beyond 1999 if the Department does not change the goals, and explained that HUD, under FHEFSSA may change the level of the goals for the years 2000 and beyond based upon HUD's experience and in accordance with HUD's statutory authority and responsibility.

In the 1995 rulemaking, HUD established the annual goals for each GSE's purchases of mortgages on housing for low-and moderate-income families as follows: for 1996, at 40 percent of the total number of dwelling units financed by each GSE's mortgage purchases; and for each of the years 1997 through 1999, at 42 percent of the total number of dwelling units financed by each GSE's mortgage purchases.[37] HUD established the following annual goals for purchases of mortgages on housing located in central cities, rural areas, and other underserved areas: 21 percent of the total number of dwelling units financed by each GSE's mortgage purchases for 1996; and 24 percent of the total number of dwelling units financed by each GSE's mortgage purchases for each of the years 1997

[34] HUD issued the proposed rule on February 16, 1995 (60 FR 9154) and the final rule on December 1, 1995 (60 FR 61846).

[35] Sec. 1332.

[36] 60 FR 61851.

[37] 24 CFR 81.12.

through 1999.[38] HUD established the annual goals for purchases of mortgages on special affordable housing as follows: for 1996, at 12 percent of the total number of dwelling units financed by each GSE's mortgage purchases; and for each of the years 1997 through 1999, at 14 percent of the total number of dwelling units financed by each GSE's mortgage purchases. The Special Affordable Housing Goal includes a subgoal for mortgage purchases financing dwelling units in multifamily housing set at 0.8 percent of the dollar volume of mortgages purchased by the respective GSE in 1994 [39]—$1.29 billion annually for Fannie Mae and $988 million annually for Freddie Mac. As described in more detail below, through 1998, the GSEs have met and in some cases exceeded the housing goals that HUD set for the 1996 to 1999 period.

C. Secretary's Approach to Regulating the Enterprises

As explained previously, the GSEs are Congressionally-chartered entities that enjoy substantial public benefits. Through these public benefits and successful corporate management strategies, the GSEs have continued to grow and to earn substantial profits for their shareholders.

In return for the public benefits they receive, Congress has mandated in the GSEs' Charter Acts that the GSEs carry out public purposes not required of other private sector entities in the housing finance industry. The GSEs' Charter Acts require them to continually assist in the efficient functioning of the secondary market for residential mortgages, including mortgages for low- and moderate-income families that may involve a reasonable economic return that is less than the economic return on other mortgages, and to promote access to mortgage credit throughout the nation, including central cities, rural areas, and other underserved areas. These requirements create an obligation for the GSEs to work to ensure that everyone throughout the country has a reasonable opportunity to enjoy access to the mortgage financing benefits resulting from the activities of these Federally-sponsored entities.

The GSEs have achieved an important part of their mission: providing stability and liquidity to large segments of the housing finance markets. As a result of the GSEs' activities, many home buyers have benefited from lower interest rates and increased access to capital, contributing, in part, to a record national homeownership rate of 66.3 percent in 1998. While the GSEs have been successful in providing stability and liquidity to certain portions of the mortgage market, the GSEs must further utilize their entrepreneurial talents and power in the marketplace and ''lead the mortgage finance industry'' to ''ensure that citizens throughout the country enjoy access to the public benefits provided by these federally related entities.'' [40]

Despite the record national homeownership rate in 1998, lower rates have prevailed for certain minorities, especially for African-American households (45.9 percent) and Hispanics (45.7 percent). These gaps are only partly explained by differences in income, age, and other socioeconomic factors. Disparities in mortgage lending are also reflected in loan denial rates of minority groups when compared to white applicants. Denial rates for conventional (non-government-backed) home purchase mortgage loans in 1997 were 53 percent for African Americans, 52 percent for Native American applicants, 38 percent for Hispanic applicants, 26 percent for White applicants, and 13 percent for Asian applicants.[41] Despite strong economic growth, low unemployment, the lowest mortgage rates in more than 30 years, and relatively stable home prices, housing problems continue to persist for low-income families and certain minorities.

Certain segments of the population have not benefited to the same degree as have others from the advantages and efficiencies provided by Fannie Mae and Freddie Mac. The GSEs have been much less active in markets where there is a need for additional financing sources to address persistent housing needs including small multifamily rental properties, manufactured housing, single family owner-occupied rental properties, seasoned affordable housing mortgages, and older housing in need of rehabilitation.

While HUD recognizes that the GSEs have played a significant role in the mortgage finance industry by providing a secondary market and liquidity for mortgage financing for certain segments of the mortgage market, it is this recognition of their ability, along with HUD's comprehensive analyses of the size of the mortgage market and the opportunities available, America's unmet housing needs, identified credit gaps, and its consideration of all the statutory factors that causes HUD to propose increased goals so that as the GSEs grow their businesses they will address new markets and persistent housing finance needs.

D. Statutory Considerations in Setting the Level of the Housing Goals

In establishing the housing goals, FHEFSSA requires the Department to consider six factors—national housing needs; economic, housing and demographic conditions; performance and effort of the GSEs toward achieving the goal in previous years; size of the conventional mortgage market serving the targeted population or areas, relative to the size of the overall conventional mortgage market; ability of the GSEs to lead the industry in making mortgage credit available for the targeted population or areas; and the need to maintain the sound financial condition of the GSEs. These factors are discussed in more detail in the following sections of this preamble and in the Appendices to this proposed rule. A summary of HUD's findings relative to each factor follows:

1. National Housing Needs. Analysis and research by HUD and others in the housing industry indicate that there are, and will continue to be in the foreseeable future, substantial housing needs among lower-income and minority families. Data from the 1990 Census and the American Housing Surveys demonstrate that there are substantial unmet housing needs among lower-income families. Many households are burdened by high homeownership costs or rent payments and will likely continue to face serious housing problems, given the dim prospects for earnings growth in entry-level occupations. According to HUD's ''Worst Case Housing Needs'' report, 21 percent of owner households faced a moderate or severe cost burden in 1995. Affordability problems were even more common among renters, with 40 percent paying more than 30 percent of their income for rent in 1995.[42]

Despite the growth during the 1990s in affordable housing lending, disparities in the mortgage market remain, with certain minorities, particularly African-American and Hispanic families, lagging the overall market in rate of homeownership. In addition, there is evidence that the aging stocks of single family rental properties and small multifamily properties with 5–50 units, which play a key role in lower-income housing, have been affected by difficulties in obtaining credit. The ability of the

[38] 24 CFR 81.13.

[39] 24 CFR 81.14.

[40] S. Rep. No. 282, 102d Cong., 2d Sess. 34 (1992).

[41] FFIEC Press Release, August 6, 1998

[42] Rental Housing Assistance—The Crisis Continues: The 1997 Report to Congress on Worst Case Housing Needs, Department of Housing and Urban Development, Office of Policy Development and Research, (April 1998).

nation to maintain the quality and availability of the existing affordable housing stock and to stabilize neighborhoods depends on an adequate supply of affordable credit to rehabilitate and repair older units.

a. *Single Family Mortgage Market.* Many younger, minority, and lower-income families did not become homeowners during the 1980s due to the slow growth of earnings, high real interest rates, and continued house price increases. Over the past six years, economic expansion, accompanied by low interest rates and increased outreach on the part of the mortgage industry, has improved affordability conditions for lower-income families. Between 1994 and 1998, record numbers of lower-income and minority families purchased homes. First time homeowners have become a major driving force in the home purchase market over the past five years. Thus, the 1990s have seen the development of a strong affordable lending market. However, despite the growth of lending to minorities, disparities in the mortgage market remain. For example, African-American applicants are still twice as likely to be denied a loan as white applicants, even after controlling for income.

b. *Multifamily Mortgage Market.* Since the early 1990s, the multifamily mortgage market has become more closely integrated with global capital markets, although not to the same degree as the single family mortgage market. Loans on multifamily properties are still viewed as riskier by some than mortgages on single family properties. Property values, vacancy rates, and market rents in multifamily properties appear to be highly correlated with local job market conditions, creating greater sensitivity of loan performance to economic conditions than may be experienced for single family mortgages.

Recent volatility in the market for Commercial Mortgage Backed Securities (CMBS), an important source of financing for multifamily properties, underlines the need for an ongoing GSE presence in the multifamily secondary market. The potential for an increased GSE presence is enhanced by the fact that an increasing proportion of multifamily mortgages are now originated in accordance with secondary market standards.

The GSEs can play a role in promoting liquidity for multifamily mortgages and increasing the availability of long-term, fixed rate financing for these properties. Increased GSE presence would provide greater liquidity to lenders, *i.e.,* a viable ''exit strategy,'' that in turn would serve to increase their lending. It appears that financing of small multifamily rental properties with 5–50 units, where a substantial portion of the nation's affordable housing stock is concentrated, have been adversely affected by excessive borrowing costs. Multifamily properties with significant rehabilitation needs also appear to have experienced difficulty gaining access to mortgage financing. Moreover, the flow of capital into multifamily housing for seniors has been historically characterized by a great deal of volatility.

2. Economic, Housing, and Demographic Conditions. Studies indicate that changing population demographics will result in a need for the mortgage market to meet nontraditional credit needs and to respond to diverse housing preferences. The U.S. population is expected to grow by an average of 2.4 million per year over the next 20 years, resulting in 1.1 to 1.2 million new households per year. In particular, the continued influx of immigrants will increase the demand for rental housing while those who immigrated during the 1980s will be in the market to purchase owner-occupied housing. The aging of the baby-boom generation and the entry of the smaller baby-bust generation into prime home buying age is expected, however, to have a dampening effect on housing demand. Non-traditional households have, and will, become more important, as overall household formation rates slow down. With later marriages, divorce, and non-traditional living arrangements, the fastest growing household groups have been single-parent and single-person households. With continued house price appreciation and favorable mortgage terms, ''trade-up buyers'' will also increase their role in the housing market. There will also be increased credit needs from new and expanding market sectors, such as manufactured housing and housing for senior citizens. These demographic trends will lead to greater diversity in the homebuying market, which, in turn, will require greater adaptation by the primary and secondary mortgage markets.

As a result of the above demographic forces, housing starts are expected to average 1.5 million units between 1999 and 2003, essentially the same as in 1996–98.[43] Refinancing of existing mortgages, which accounted for 50 percent of originations in 1998, has continued to play a major role in 1999, but is expected to return to more normal levels during 2000. Thus, the mortgage market remained strong with over one trillion dollars in expected originations in 1999, and a somewhat lower number of originations are expected in 2000.

3. Performance and Effort of the GSEs Toward Achieving the Goal in Previous Years. Both Fannie Mae and Freddie Mac have improved their affordable housing loan performance over the past five years. However, the GSEs' mortgage purchases continue to lag the overall market in providing financing for affordable housing to underserved borrowers and their neighborhoods, indicating that there is more that the GSEs can do to improve their performance. In addition, a large percentage of the lower-income loans purchased by the GSEs have relatively high down payments, which raises questions about whether the GSEs are adequately meeting the needs of those lower-income families which have little cash for making large down payments but can fully meet their monthly obligations. The discussion of the performance and effort of the GSEs toward achieving the housing goals in previous years is specific to each of the three housing goals. This topic is discussed further in Section II., B., ''Subpart B—Housing Goals'' below and in the Appendices to this proposed rule.

4. Size of the Conventional Mortgage Market Serving the Targeted Population or Areas, Relative to the Size of the Overall Conventional Mortgage Market. The Department's analyses indicate that the size of the conventional conforming market relative to each housing goal is greater than earlier estimates based mainly on HMDA data for 1992 through 1994 used in establishing the 1995–1999 housing goals. Due to inherent uncertainty about future market conditions, HUD has developed a plausible range under each goal, rather than a point estimate, for the current market. The discussion of the size of the conventional mortgage market serving targeted populations or areas relative to the size of the overall conventional mortgage market is specific to each of the three housing goals. The Department's estimate of the size of the conventional mortgage market is discussed further below in Section I, ''Setting the Level of the Housing Goals,'' Section II., B., ''Subpart B—Housing Goals'' and in the Appendices to this proposed rule.

5. Ability of the GSEs to Lead the Industry in Making Mortgage Credit Available for the Targeted Population or Areas. Research concludes that the GSEs have generally not been leading the market, but have lagged behind the primary market in financing housing for

[43] Standard & Poor's DRI Review of the U.S. Economy. (September 1999), p. 53–55.

lower-income families and their communities. However, the GSEs' state-of-the-art technology, staff resources, share of the total conventional conforming market, and their financial strength suggest that the GSEs have the ability to lead the industry in making mortgage credit available for lower-income families and underserved neighborhoods.

The legislative history of FHEFSSA indicates Congress's strong concern that the GSEs need to do more to benefit low- and moderate-income families and the residents of underserved areas that lack access to credit.[44] The Senate Report on FHEFSSA emphasized that the GSEs should ''lead the mortgage finance industry in making mortgage credit available for low- and moderate-income families.''[45] FHEFSSA, therefore, specifically required that HUD consider the ability of the GSEs to lead the industry in establishing the level of the housing goals. FHEFSSA also clarified the GSEs' responsibility to complement the requirements of the Community Reinvestment Act[46] and fair lending laws[47] in order to expand access to capital to those historically underserved by the housing finance market.

During the 1995 rulemaking, HUD received comments regarding what it means for the GSEs to ''lead the industry.'' The GSEs themselves and others pointed out that the GSEs are often ''leaders'' through their introduction of innovative products, technology, and processes. For example, both GSEs have introduced technological advances through their development of automated underwriting systems. Fannie Mae has also developed state-of-the-art mapping software for use by lenders, nonprofit organizations, and State and local governments to help implement community lending programs. In addition, Fannie Mae has established partnership offices in more than 30 cities, allowing it to reach out to local lenders and affordable housing groups regarding Fannie Mae's programs. While Freddie Mac has not established partnership offices, it has established alliances at the national and local level to expand affordable housing opportunities. Nonetheless, while the GSEs are ''leaders'' in these areas, leadership also involves increasing the availability of financing for homeownership and affordable rental housing. Thus, the GSEs' obligation to ''lead the industry'' also entails leadership in facilitating access to affordable credit in the primary market for borrowers at different income levels and housing needs, as well as for underserved urban and rural areas.

While the GSEs cannot be expected to solve all of the nation's housing problems, the efforts of Fannie Mae and Freddie Mac have not matched the opportunities that are available in the primary mortgage market. Although the GSEs were directed by Congress to ''lead the mortgage finance industry in making mortgage credit available for low- and moderate-income families,'' depository institutions have been more successful than the GSEs in providing affordable loans to lower income borrowers and in historically underserved neighborhoods.

For example, very low-income borrowers accounted for 9.9 percent of Freddie Mac's purchases of home loans in 1998, 11.4 percent of Fannie Mae's purchases, 15.2 percent of home loans originated and retained by depository institutions, and 13.3 percent of home purchase mortgages originated in the overall conventional conforming market. Similarly, mortgage purchases on properties located in underserved areas accounted for 20.0 percent and 23.5 percent of Freddie Mac's and Fannie Mae's purchases of home loans, respectively, 26.1 percent of home purchase mortgages originated and retained by depository institutions and 24.6 percent of home purchase mortgages originated in the overall conventional conforming market. Since 1992, Fannie Mae has improved its affordable lending performance and has made progress toward closing the gap between its performance and that of the overall mortgage market. Freddie Mac has shown less improvement and, as a result, has not made as much progress in closing the gap between its performance and that of the overall market for home loans.

The GSEs have been much less active in providing financing for the multifamily rental housing market. In 1997, Fannie Mae's multifamily purchases amounted to $6.9 billion and Freddie Mac's, $2.7 billion, for total multifamily purchases of $9.6 billion. The GSEs' purchases have accounted for approximately 22 percent of the multifamily dwelling units that were financed in 1997. By way of comparison, HUD estimates that 4.9 million units were financed by mortgages on single family owner-occupied properties in 1997, and the GSEs have financed 2.4 million, or 49 percent of these units. Thus, the GSEs' presence in the multifamily mortgage market was less than one-half of their presence in the market for mortgages on single family owner-occupied properties.

In addition, the GSEs continue to lag the overall conforming, conventional market in providing affordable home purchase loans to underserved neighborhoods. During 1998, mortgages financing housing in underserved census tracts (as defined by HUD)[48] accounted for 20.0 percent of Freddie Mac's single family mortgage purchases, compared with 22.9 percent of Fannie Mae's single family mortgage purchases, 26.1 percent of mortgage loans originated and held in portfolio by depository institutions, and 24.6 percent of the overall conforming conventional mortgage market. Fannie Mae has improved its performance in underserved areas to almost reach market levels. However, Freddie Mac has made much less progress through 1998 in serving families living in underserved neighborhoods.

Additionally, a large percentage of the lower-income loans purchased by both GSEs have relatively high down payments, which raises questions about whether the GSEs are adequately meeting the needs of lower-income families, who find it difficult to raise enough cash for a large down payment. Also, while single family rental properties are an important source of low- and moderate-income rental housing, they represent only a small portion of the GSEs' business.

The Appendices to this proposed rule provide more information on HUD's analysis of the extent to which the GSEs have not led the mortgage industry in funding loans to underserved borrowers and neighborhoods. From this analysis of the GSEs' performance in comparison with the primary mortgage market and with other participants in the mortgage markets, it is clear that the GSEs need to improve their performance relative to the primary market of conforming conventional mortgage lending. The need for improvements in the GSEs' performance is especially apparent with respect to the single family and multifamily rental markets.

6. Need to Maintain the Sound Financial Condition of the GSEs. Based on HUD's economic analysis and discussions with the Office of Federal Housing Enterprise Oversight, HUD concludes that the proposed level of the goals will not adversely affect the sound financial condition of the GSEs.

E. Setting the Level of the Housing Goals

There are several reasons the Department, having considered all the

[44] See, e.g., S. Rep. at 34.

[45] S. Rep. at 34.

[46] 12 U.S.C. 2901 *et seq.*

[47] See section 1335(3)(B).

[48] 24 CFR 81.2(b).

statutory factors, is proposing increases in the housing goals.

1. *Market Needs and Opportunities.* First, the GSEs appear to have substantial room for growth in serving the affordable housing mortgage market. For example, the Department calculated that the two GSEs' mortgage purchases accounted for 39 percent of the total conventional mortgage market during 1997 (as measured by the total number of units financed by the GSEs). In contrast, GSE purchases comprised only 30 percent of the low- and moderate-income mortgage market in 1997, 33 percent of the underserved areas market, and, a still smaller, 24 percent of the special affordable market.

The GSEs' role in the mortgage market varies somewhat from year to year in response to changes in interest rates, mortgage product types, and a variety of other factors. But underlying market trends show a clear and significant increase in the GSEs' role. Specifically, OFHEO estimates that the share (in dollars) of single-family mortgages outstanding accounted for by mortgage-backed securities issued by the GSEs and by mortgages held in the GSEs' portfolios has risen from 31 percent in 1990 to 37 percent in 1992, 40 percent in 1994, 43 percent in 1996, and 45 percent in 1998. In absolute terms, the GSEs' presence has grown even more sharply, as the total volume of single-family mortgage debt outstanding has increased rapidly over this period.

The GSEs have indicated that they expect their role in the mortgage market to continue to increase in the future, as they develop new products, refine existing products, and enter markets where they have not played a major role in the past. The Department's goals for the GSEs also anticipate that their involvement in the mortgage market will continue to increase.

The Department estimates that 7.4 million owner-occupied and rental units were financed by conventional conforming mortgages in 1997, and that the GSEs provided financing for 39 percent, or 2.9 million, of these units. However, the GSEs' mortgage market presence varies significantly by property type—while they accounted for about 49 percent of the owner-occupied units financed in the primary market in that year, their role was much less in the mortgage market for mortgages on rental properties.

Specifically, HUD estimates that Fannie Mae and Freddie Mac accounted for only about 19 percent of rental units financed in 1997. And within the rental category, the GSEs have yet to play a major role in financing mortgages for single family rental properties—those with at least one rental unit and no more than four units in total.

For the types of units covered by HUD's goals, the GSEs' role is significantly less than their overall market presence of 39 percent. Specifically, HUD estimates that Fannie Mae and Freddie Mac financed 33 percent of the units that qualified for the Geographically Targeted Goal. The GSEs' role was even lower for HUD's other two goals—they financed just 31 percent of units qualifying for the Low- and Moderate-Income Housing Goal, and only 24 percent of special affordable units, for very low-income families and low-income families in low-income areas.

There are a number of relatively untapped segments of the multifamily, single-family owner, and single-family rental markets where the GSEs might play an enhanced role and thereby increase their shares of targeted loans and their performance on the housing goals. Six such areas are discussed below.

a. *Small Multifamily Properties.* One sector of the multifamily mortgage market where the GSEs could play an enhanced role involves loans on small multifamily properties—those containing 5–50 units. The GSEs typically purchase relatively few of these loans, which account for 37 percent of the stock of all multifamily units in mortgaged properties, according to the 1991 Survey of Residential Finance.

HUD estimates that the GSEs acquired loans financing only four percent of units in small multifamily properties originated during 1995 through 1997. This is substantially less than the GSEs' presence in the overall multifamily mortgage market, which the Department estimates was 22 percent in 1997.

Increased purchases of small multifamily mortgages would make a significant contribution to performance on the goals, since the percentages of these units qualifying for the income-based housing goals are high—in 1998, 94 percent of units backing both GSEs' combined multifamily mortgage purchases qualified for the Low- and Moderate-Income Housing Goal and about 55 percent of units backing Freddie Mac's multifamily mortgage purchases met the Special Affordable Housing Goal.[49]

b. *Multifamily Rehabilitation Loans.* Another multifamily market segment holding potential for expanded GSE presence involves properties with significant rehabilitation needs.

Properties that are more than 10 years old are typically classified as ''C'' or ''D'' properties, and are considered less attractive than newer properties by many lenders and investors. Fannie Mae's underwriting guidelines for negotiated transactions state that ''the Lender is required to use a more conservative underwriting approach'' for transactions involving properties 10 or more years old. Fannie Mae funding for rehabilitation projects is generally limited to $6,000 per unit. Multifamily rehabilitation loans accounted for only 0.5 percent of units backing Fannie Mae's 1998 purchases. Freddie Mac's purchases of multifamily rehabilitation loans in 1998 were 1.9 percent of its multifamily total.

c. *Single Family Rental Properties.* Studies show that single family rental properties are a major source of affordable housing for lower-income families. Yet, these properties are only a small portion of the GSEs' overall business.

HUD estimates that approximately 127,000 mortgages were originated on owner-occupied single-family rental properties in 1997. These mortgages financed a total of 286,000 units—the owner units plus an additional 159,000 rental units. Data submitted to HUD by the GSEs indicates that the GSEs combined to finance 94,000 such units, only 33 percent of the units financed in the primary market.

There is ample room for an enhanced GSE role in this ''goal-rich'' market. For the GSEs combined, 64 percent of the units in these properties qualified for the low-mod goal in 1997, 33 percent qualified for the special affordable goal, and 56 percent qualified for the underserved areas goal. Thus significant gains could be made in performance on all of their goals if Fannie Mae and Freddie Mac played a larger role in the market for mortgages on single-family 2–4 unit owner-occupied properties.

d. *Manufactured Homes.* The Manufactured Housing Institute, in its Annual Survey of Manufactured Home Financing, reported that 116 reporting institutions originated $15.6 billion in consumer loans on manufactured homes in 1998, and that, with an average loan amount of about $30,000, approximately 520,000 loans were originated.

While the GSEs have traditionally played a minimal role in financing manufactured housing, they have recently stepped up their activity. But, even with this stepped-up activity in this market, the GSEs' purchases probably accounted for less than 15 percent of total loans on manufactured

[49] Fannie Mae did not obtain some of the data necessary to qualify many of their multifamily loans for the Special Affordable Housing Goal.

homes in 1998—a figure well below their overall market presence of 39 percent.

There is ample room for an enhanced GSE role in this market, with its high concentration of goals-qualifying mortgage loans. For loans reported in 1998 in accordance with HMDA by 21 manufactured housing lenders, 76 percent qualified for the low-mod goal in 1998, 42 percent qualified for the special affordable goal, and 47 percent qualified for the underserved areas goal. Thus manufactured housing has significantly higher shares of goal-qualifying loans than all single-family owner-occupied properties, though they are not quite as ''goal-rich'' as loans on multifamily properties. In general, though, goal performance could be enhanced substantially if the GSEs were to play an increased role in the manufactured housing mortgage market.

e. *A-Minus Loans.* Industry sources estimate that subprime mortgage originations amounted to about $125 billion in 1997, and that these loans are divided evenly between the more creditworthy (''A-minus'') subprime borrowers and less creditworthy (''B,'' ''C,'' and ''D'') borrowers. Based on HMDA data for 200 subprime lenders, the Department estimates that 58 percent of the units financed by subprime loans qualified for the low-mod goal in 1997, 29 percent qualified for the special affordable goal, and 45 percent qualified for the underserved areas goal.

Freddie Mac has begun to purchase loans originated in the A-minus mortgage market, as long as the loans are processed through its Loan Prospector system. Freddie Mac has estimated that 10–30 percent of subprime borrowers would qualify for a prime conventional loan. Freddie Mac has also purchased subprime loans through structured transactions that limit Freddie Mac's risk to the ''A'' piece of a senior-subordinated transaction. Fannie Mae recently introduced a program aimed at borrowers with past credit problems that would lower the interest rates for those borrowers that were timely on their mortgage payments.

However, there is ample room for further enhancement of both GSEs' roles in the A-minus market. A larger role by the GSEs could help standardize mortgage terms in this market, which would lead to lower interest rates.

f. *Seasoned Mortgages.* Over the past five years, depository institutions (banks and thrifts) have been expanding their affordable loan programs and, as a result, have originated substantial numbers of loans to low-income and minority borrowers and their neighborhoods. Much of this outreach to underserved communities is due to the Community Reinvestment Act (CRA), which requires depository institutions to help meet the credit needs of their communities. A large number of the ''CRA-type'' loans that have recently originated remain in thrift and bank portfolios; selling these loans on the secondary market would free up capital for depositories to originate new CRA loans. Given its enormous size, the CRA market segment provides an opportunity for Fannie Mae and Freddie Mac to expand their affordable lending programs. While some of these loans, when originated, may not have met the GSE's underwriting guidelines, it appears they are beginning to be purchased by GSEs after the loans have seasoning and through various structured transactions. As explained in Appendix A, Fannie Mae is beginning to purchase these seasoned loans, which has improved its performance on the housing goals. Freddie Mac, on the other hand, has not been as active as Fannie Mae in purchasing seasoned ''CRA-type'' loans. With billions of dollars worth of CRA loans in bank portfolios, the early experience of Fannie Mae suggests that this could not only be an important strategy for reaching the housing goals but could also provide needed liquidity for a market that is serving the needs of low-income and minority homeowners.

2. *Market Share Higher Than Goal Levels.* The shares of the mortgage markets that qualify for each of the housing goals are higher than the current goals. Specifically, the current Low-and Moderate-Income Housing Goal for 1997 through 1999 is 42 percent, but the market share for low- and moderate-income mortgages is estimated at 50–55 percent. The Geographically Targeted Goal for 1997 through 1999 is 24 percent, but the estimated market share of geographically targeted mortgages is 29–32 percent. The Special Affordable Housing Goal for 1997 through 1999 is 14 percent, but the estimated special affordable market share is 23–26 percent.[50] Thus, the proposed increases in the housing goals, described below, will significantly reduce the disparities that currently exist between the housing goals and HUD's market estimates. HUD's analysis indicates that the proposed goals are reasonable and feasible under more adverse economic environments than have recently existed. Reasons for the remaining disparity between the proposed GSE housing goals and the respective shares of the overall mortgage market qualifying for each of the housing goals are discussed below in Section E.7, ''Closing The Gap Between the GSEs and The Market.''

3. *Need for Increased Affordable Single Family Mortgage Purchases.* Higher housing goals are needed to assure that both Fannie Mae and Freddie Mac increase their purchases of single family mortgages for lower-income families. The GSEs lag behind depository institutions and other lenders in the conventional conforming market in providing mortgage funds for these underserved families and their neighborhoods. Numerous studies have concluded that Fannie Mae and, especially, Freddie Mac have room to increase their purchases of affordable loans originated by primary lenders. The single family affordable market, which had only begun to grow when HUD set housing goals in 1995, has now established itself with six straight years (1993–1998) of solid performance. Current economic forecasts suggest that the strong housing affordability of the past several years will be maintained in the post-1999 period, leading to additional opportunities for the GSEs to support mortgage lending benefiting families targeted by the housing goals. But, as explained in Appendix D, HUD's housing market estimates allow for more adverse economic conditions than have existed recently.

4. *Market Disparities.* Despite the recent growth in affordable lending, there are many groups who continue to face problems obtaining mortgage credit and who would benefit from a more active and targeted secondary market. Homeownership rates for lower-income families, certain minorities, and central city residents are substantially below those of other families, and the disparities cannot simply be attributed to differences in income. Immigrants represent a ready supply of potential first-time home buyers and will need access to mortgage credit. Special needs in the market, such as rehabilitation of older 2–4 unit properties, could be helped by new mortgage products and more flexibility in underwriting and appraisal guidelines. The GSEs, along with primary lenders and private mortgage insurers, have been making efforts to reach out to these underserved portions of the markets. However, more needs to be done, and the proposed increases in the housing goals are

[50] The low-and moderate-income market share is the estimated proportion of newly mortgaged units in the market serving low-and moderate-income families. The two other shares are similarly defined. HUD's range of estimates (such as 50–55 percent) reflects uncertainty about future market conditions.

intended to encourage additional efforts by Fannie Mae and Freddie Mac.

5. *Impact of Multifamily Mortgage Purchases.* When the 1996–99 goals were established in December 1995, Freddie Mac had only recently reentered the multifamily mortgage market, after an absence in the early 1990s. Freddie Mac has made progress in rebuilding its multifamily mortgage purchase program, with its purchases of these loans rising from $191 million in 1993 to $6.6 billion in 1998. Freddie Mac's limited role in the multifamily market was a significant constraint when HUD set the level of the housing goals for 1996 through 1999. While Freddie Mac has made progress by establishing a solid foundation of multifamily mortgage purchases, they still lag the market in this area. Accordingly, the Department is proposing to provide Freddie Mac with a temporary adjustment factor for purchases of mortgages in multifamily properties with more than 50 units, as discussed in more detail, below.

6. *Financial Capacity to Support Affordable Housing Lending.* A wide variety of quantitative and qualitative indicators demonstrate that the GSEs' have ample, indeed robust, financial strength to improve their affordable lending performance. For example, the combined net income of the GSEs has risen steadily over the last decade, from $677 million in 1987 to $5.1 billion in 1998, an average annual growth rate of 20 percent per year. This financial strength provides the GSEs with the resources to lead the industry in making mortgage financing available for families and neighborhoods targeted by the housing goals.

7. *Closing the Gap Between the GSEs and the Market.* This section discusses the relationship between the housing goals, HUD's market estimates, and key segments of the affordable market in which the GSEs have had only a weak presence. To lay the groundwork for this discussion, the following table summarizes the Department's findings regarding market estimates and GSE performance as well as the levels of the housing goals during 1997–1999 and the goals proposed here:

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Percentage of Eligible Units Financed:

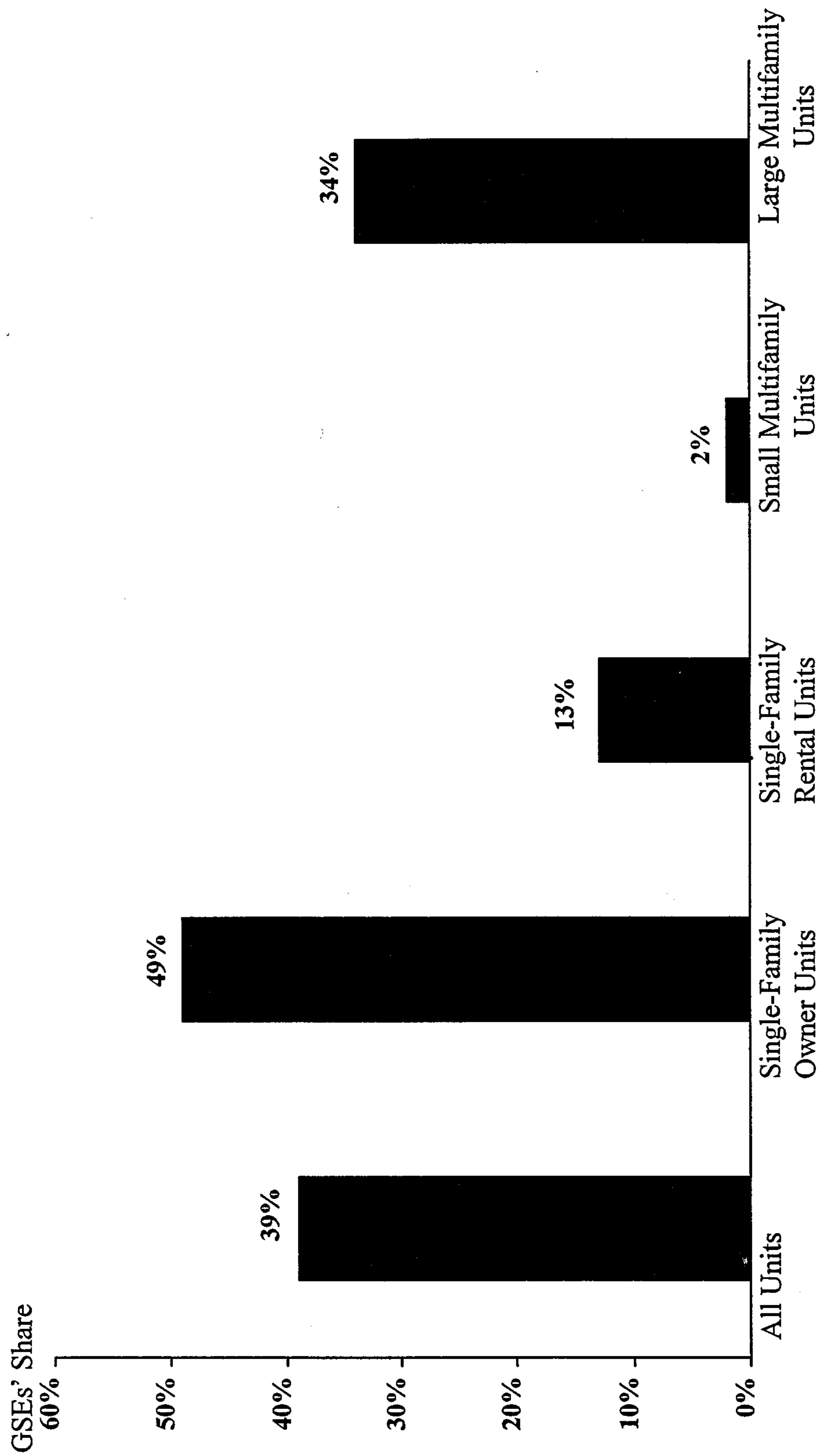
	1997-1999 Requirement	2001-2003 Proposed Requirements[1]	GSEs' Average Performance 1996-1998 (Fannie Mae/ Freddie Mac)	HUD's Estimated 1995-1997 Market Average[2]	HUD's Projected Market Estimate
Low-and Moderate Income Goal	42%	50%	45.1% 42.2%	57.3%	50-55%
Geographically Targeted Goal	24%	31%	28.0% 25.8%	33.1%	29-32%
Special Affordable Housing Goal	14%	20%	15.6% 15.0%	28.6%	23-26%

[1] Proposed year 2000 transition goals are 48 percent, 29 percent, and 18 percent, respectively.

[2] Appendix D explains the specific reasons the 1995-97 market estimates for the low-mod and special affordable goals are higher than the upper end of HUD's market projections for the years 2000-2003. Based on average 1993-98 experience, HUD's projection model assumes that refinance borrowers have higher incomes that home purchase borrowers; however, during the 1995-97 period, refinance borrowers had lower incomes. The 1995-97 period also exhibited a slightly higher percentage of rental units financed than assumed in HUD's projection model. See Appendix D for other reasons the 1995-97 market estimates are higher than those projected for the years 2000-2003.

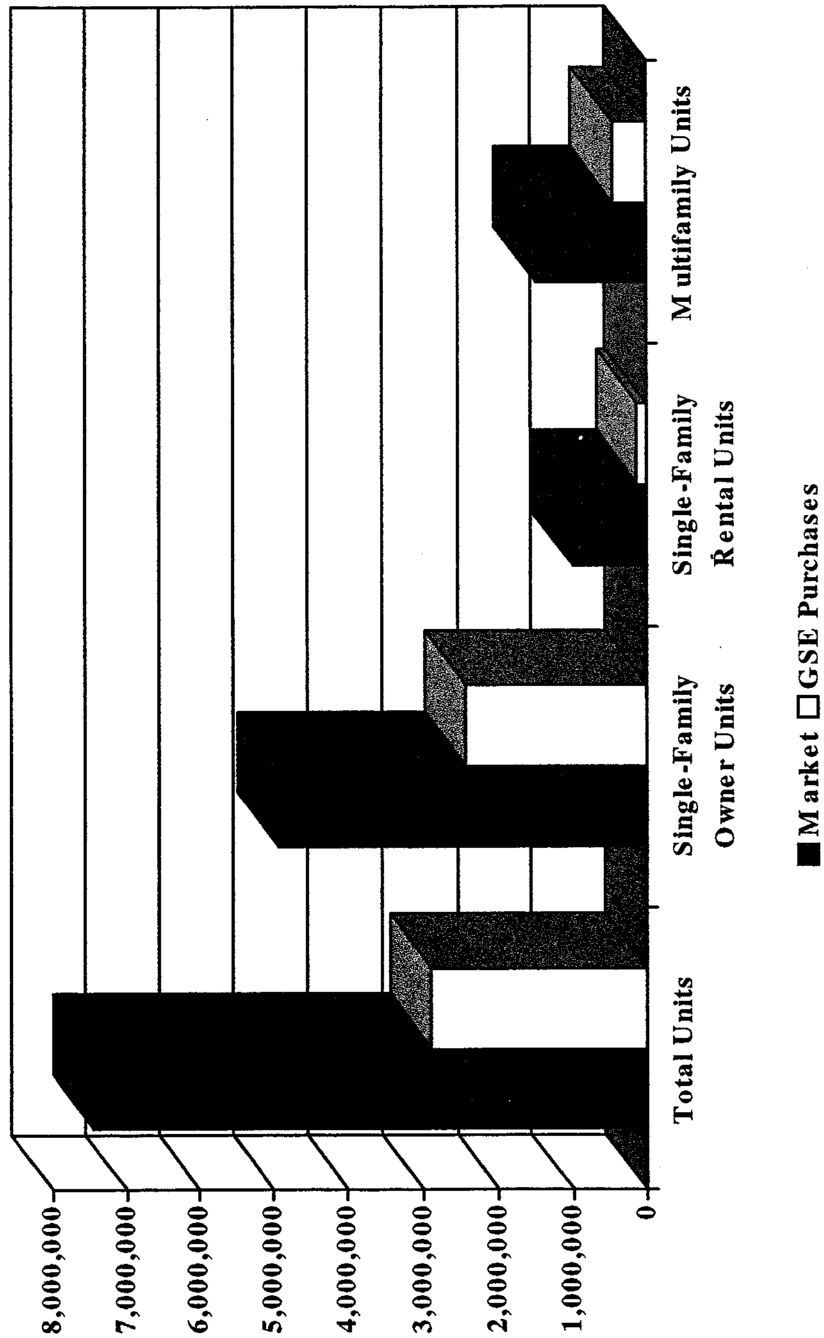
It is evident from this table that the proposed Low- and Moderate-Income and Special Affordable Housing Goals are below HUD's projected market estimate for the years (2000–2003) covered by the proposed housing goals. One reason for this disparity involves disaggregating GSE purchases by property type, which shows that the GSEs have little presence in some important segments of the affordable housing market. For example, as shown in Figure 1, in 1997 the GSEs purchased loans representing only 13 percent of units in single-family rental properties, and only 2 percent of units in small multifamily properties mortgaged that year. (Figure 2 provides additional detail providing unit data comparing the GSEs' with the conventional conforming market). Typically, more than 90 percent of units in single-family rental and small multifamily properties qualify for the Low- and Moderate-Income Housing Goal. Thus, one reason why the GSEs' performance on the Low- and Moderate-Income Housing Goal falls short of HUD's market estimate, is that the GSEs have had only a weak and inconsistent presence in financing these important sources of affordable housing, but these market segments are important components in the market estimate.

Figure 1
GSEs' Share of the 1997 Conventional Conforming Market by Property Type



Source: See Table A7, Appendix A, and discussion of mortgages on small multifamily properties in Appendix A, Section G.

Figure 2
Units in the 1997 Conventional Conforming Mortgage Market Compared to GSE Purchases By Property Type



Source: See Table A.7, Appendix A.

The same disparities are seen in figures relating to GSE purchase shares and market shares in the relevant market segments, as utilized by HUD in preparing its market estimates for the Low- and Moderate-Income Housing Goal. In the overall conventional mortgage market, units in single-family rental properties and small multifamily properties are expected to represent approximately 19 percent of the overall mortgage market, and 31 percent of units backing mortgages qualifying for the Low- and Moderate-Income Housing Goal. Yet in 1997, units in such properties accounted for 5.5 percent of the GSEs' overall purchases, and only 10.5 percent of GSE purchases meeting the Low- and Moderate-Income Housing Goal. The continuing weakness in GSE purchases of mortgages on single-family rental and small multifamily properties is a major factor explaining the shortfall between GSE performance and that of the primary mortgage market.

For a variety of reasons, the GSEs have historically viewed the single-family rental and small multifamily market segments as more difficult for them to penetrate than the single-family owner-occupied mortgage market. In order to provide the GSEs with an incentive to enter these markets and provide the benefits of more consistent exposure to secondary markets, HUD is proposing to award ''bonus points'' for their purchases of mortgages on owner-occupied single-family rental properties and small multifamily properties in calculating credit toward the housing goals, as discussed below. The bonus points will make the Department's proposed housing goals easier for the GSEs to attain if they devote resources to affordable market segments where their past role has been limited. Further, awarding bonus points for these units would have resulted in some increases in the GSEs' performance for the three goals over the 1996–98 period. (See Subpart B, 5a.).

Because of the importance of the GSEs' ability to lead the industry in making mortgage credit available for targeted populations and areas, HUD wishes to solicit comments on the following:

Are the proposed housing goals appropriate given the statutory factors HUD must consider in setting the goals, and in light of the market estimates of the GSEs' share of the affordable housing market?

F. Principles Governing Regulation of the GSEs

In proposing these regulations, the Department was guided by and affirmed the following principles established in the 1995 rulemaking:

1. To fulfill the intent of FHEFSSA, the GSEs should lead the industry in ensuring that access to mortgage credit is made available for very low-, low- and moderate-income families and residents of underserved areas. HUD recognizes that, to lead the mortgage industry over time, the GSEs will have to stretch to reach certain goals and close the gap between the secondary mortgage market and the primary mortgage market. This approach is consistent with Congress' recognition that ''the enterprises will need to stretch their efforts to achieve'' the goals.[51]

2. The Department's role as a regulator is to set broad performance standards for the GSEs through the housing goals, but not to dictate the specific products or delivery mechanisms the GSEs will use to achieve a goal. Regulating two exceedingly large financial enterprises in a dynamic market requires that HUD provide the GSEs with sufficient latitude to use their innovative capacities to determine how best to develop products to carry out their respective missions. HUD's regulations should allow the GSEs to maintain their flexibility and their ability to respond quickly to market opportunities. At the same time, the Department must ensure that the GSEs' strategies serve all families and markets and address unmet credit needs. The addition of subgoals and/or bonus points to the regulatory structure may provide an additional means of encouraging the GSEs' affordable housing activities to address identified, persistent credit needs while leaving the specific approaches to meeting these needs to the GSEs.

3. Discrimination in lending—albeit sometimes subtle and unintentional—has denied racial and ethnic minorities the same access to credit to purchase a home that has been available to similarly situated non-minorities. The GSEs have a central role and responsibility to promote access to capital for minorities and other identified groups and to thereby exhibit the feasibility of such lending.

4. In addition to the GSEs' purchases of single family home loans, the GSEs also must continue to assist in the creation of an active secondary market for multifamily loans. Affordable rental housing is essential for those families who cannot afford to become homeowners. The GSEs must assist in making capital available to assure the continued development of rental housing.

[51] See footnote 40.

II. Discussion of Proposed Regulatory Changes

This proposed rule includes changes to definitions applicable to the housing goals, establishment of new housing goal levels, new requirements for counting mortgage purchases under the goals, discussion of possible regulatory incentives intended to spur greater GSE involvement in untapped segments of the affordable housing market, and an expansion of data available to the public on the GSEs' mortgage loan purchases. Much of the analysis referenced in this discussion is based on data through calendar year 1997. Information on the GSEs' mortgage purchases for 1998 is referenced where feasible.

Many of the proposed rule changes, included in the final rule, will involve changes in data reporting requirements. The final rule will identify the specific changes to data reporting necessary to implement any new requirements for counting mortgage purchases under the housing goals.

A. Subpart A—General

Since 1996, as a result of HUD's experience with the 1995 GSE rule, the Department has identified several definitions that require greater clarity to ensure consistent application of the housing goal requirements. Accordingly, some definitional changes are proposed for this purpose. Other definitional changes would be necessary as a result of the proposed changes to the housing goals. These types of definitional changes are discussed in the following Subpart B—Housing Goals.

1. *Definitions.* The following definitions are proposed to be added or revised in order to provide greater clarity, consistency and guidance with regard to this regulation.

a. *Metropolitan Area.* This rule proposes to revise the existing definition of ''Metropolitan Area'' to correct an ambiguity in the relevant area for defining median incomes. ''Metropolitan Area'' is defined in § 81.2 of the current regulation as a ''metropolitan statistical area (MSA), a primary metropolitan statistical area (PMSA), or a consolidated metropolitan statistical area (CMSA), designated by the Office of Management and Budget of the Executive Office of the President.'' This definition gives rise to an ambiguity in the definitions of underserved area and the denominator of the affordability ratio used to compute the Low- and Moderate-Income Housing Goal and Special Affordable Housing Goal in whether to use the median income of the CMSA or the PMSA. For example, the underserved area definition requires that the denominator be the metropolitan area median income. Should the median income of a census tract in Washington, D.C. be compared to median income of the Washington PMSA or the Baltimore-Washington CMSA? HUD has consistently defined underserved areas, as well as denominators for the other goals, using the median incomes of the PMSA. This rule would correct this ambiguity by revising the definition of ''Metropolitan Area'' in § 81.2 to eliminate the reference to CMSAs.

b. *Median Income.* Under § 81.2 of HUD's current regulations, the definition of ''Median Income'' with respect to an area is the unadjusted median family income for the area, as most recently determined and published by the Department; ''area'' includes metropolitan areas. ''Metropolitan Area'' is defined in § 81.2 in terms of areas designated as such by OMB. These definitions give rise to an inconsistency, in that HUD routinely publishes area median family income estimates but, in some cases, determines them not for MSAs, or PMSAs, but rather for portions of such areas. For example, OMB defines the Washington D.C. PMSA to include Berkeley and Jefferson counties in West Virginia and Culpeper, King George and Warren counties in Virginia. However, HUD's published area income estimates for these five counties are based on the incomes specific to these counties, not the PMSA. Moreover, HUD's published area income estimates for the other counties in the Washington MSA are based on data pertaining to the remaining counties and disregarding data for these five counties. As another example, OMB defines the New York City PMSA to include Rockland and Westchester Counties. HUD's published area income estimates for these two counties are based on incomes specific to the counties, not the PMSA. HUD's published area income estimates for the other counties in the New York City PMSA are based on data pertaining to the entire New York City PMSA including Rockland and Westchester Counties. Such differences between HUD's published area estimates and MSAs have led to ambiguity concerning the appropriate determination of area incomes by the GSEs. HUD proposes to change the definition of ''Median Income'' to require the GSEs to use HUD estimates of median family income. As part of this change to the definition of ''Median Income,'' HUD would provide the GSEs, on an annual basis, with information specifying how HUD's published median family income estimates are to be applied.

c. *Underserved Area.* This rule proposes to revise the existing definition of ''Underserved Area'' to correct the parameters of rural underserved areas. The definition of rural underserved areas in § 81.2 has an ''income-only'' portion (*i.e.,* a median income at or below 95 percent of the state non-metropolitan median income or the nationwide non-metropolitan median income, whichever is greater) and ''income/minority'' portion (i.e., a median income at or below 120 percent of the state non-metropolitan median income and a minority population of at least 30 percent). In the preamble to the 1995 Final Rule, HUD explained that for the income only portion of the definition, the median income of a county would be compared to the greater of either the state or the nationwide non-metropolitan median income, in order to ensure that poor counties in poor states would be included in the definition. However, the 1995 Final Rule did not recognize this comparison in the ''income/minority'' portion. Therefore, this proposed rule would correct this oversight by proposing to revise the definition of ''Underserved Areas'' in § 81.2. This rule also proposes a specific change to this definition related to tribal lands and discusses other possible changes to the definition related to metropolitan and non-metropolitan (rural) areas. The changes are proposed are discussed below in Section B., 3., e., ''Central Cities, Rural Areas and Other Underserved Areas Housing Goal.''

B. Subpart B—Housing Goals

1. *Background.* The Department is required to establish, by regulation, annual housing goals for each GSE. The goals include a Low- and Moderate-Income Goal, a Special Affordable Housing Goal, and a Central Cities, Rural Areas, and Other Underserved Areas Housing Goal (the Geographically Targeted Goal). Section 1331(a) of FHEFSSA requires HUD to establish these goals in a manner consistent with sections 301(3) of the Fannie Mae Charter Act and 301(b)(3) of the Freddie Mac Charter Act, which require the GSEs ''to provide ongoing assistance to the secondary market for residential mortgages (including * * * mortgages on housing for low- and moderate-income families involving a reasonable economic return that may be less than the return earned on other activities).'' Under section 1331(c) of FHEFSSA, HUD may, by regulation, adjust any housing goal from year to year.

In December 1995, HUD established housing goals for the GSEs for 1996–1999, revising and restructuring the transition goals that had been in effect for 1993–1995. The current housing goal levels, which were in place for 1996–1999, are:

A *Low- and Moderate-Income Housing Goal,* which focuses on mortgages on housing for families with incomes no greater than area median income (as defined by HUD),[52] and which was set at 40 percent of total units financed by each of the GSEs' mortgage purchases in 1996 and 42 percent for each calendar year from 1997 though 1999;

A *Geographically Targeted Goal,* which focuses on mortgages on properties located in ''underserved areas,'' defined as low-income and/or high-minority census tracts and rural counties (excluding high-income, high-minority tracts), and which was set at 21 percent of total units financed by each of the GSEs' mortgage purchases in 1996 and at 24 percent for each calendar year from 1997 through 1999;

A *Special Affordable Housing Goal,* which focuses on mortgages on housing for very low-income families and low-income families living in low-income areas, and which was set at 12 percent of total units financed by each of the GSEs' mortgage purchases in 1996 and at 14 percent for calendar each year from 1997 through 1999; and

A *Special Affordable Multifamily Housing Subgoal,* which focuses on mortgages on housing for very low-income families and low-income families living in low-income areas, in multifamily properties (defined as properties with five or more units), and which was set at a fixed amount of 0.8 percent of the total dollar volume of mortgages purchased by each GSE in 1994. This formula results in a subgoal of special affordable multifamily mortgage purchases totaling $1.29 billion per year for Fannie Mae and $988 million per year for Freddie Mac for each calendar year from 1996 through 1999.

These housing goals, excluding the special affordable multifamily housing subgoal, share common characteristics: (1) Annual goal levels are the same for both GSEs; (2) they are percentage based goals defined in terms of percentages of housing units financed; and (3) one unit may qualify for one or more goals. In addition, under the current regulation, goals were established based on consideration of the statutory factors and set for a four-year period from 1996 through 1999 to allow the GSEs time to develop long-range strategies.

A key factor in determining the level of the goals was and is the estimated

[52] 24 CFR 81.2.

size of the conventional market for each goal. In 1995, HUD estimated the low- and moderate-income share of the conventional market at 48–52 percent; the underserved (geographically targeted) areas share at 25–28 percent; and the special affordable share at 20–23 percent. These market estimates were based mainly on HMDA data for 1992 to 1994. Upon further analysis, however, these estimates are below what actual data shows for the period from 1995 to 1998. For example, HUD's 1995 market estimates underestimated the size of the rental market and did not anticipate the underlying strength and persistence of the affordable lending market. A large portion of new mortgages were originated for low-income families and first time homebuyers during the 1995 to 1998 period. Therefore, HUD estimates that the low- and moderate-income market accounted for 57–58 percent of all mortgages originated during the 1995 to 1997 period, and for 54 percent during the heavy refinancing year of 1998. Appendix D, ''Estimating the Size of the Conventional Conforming Market for each Housing Goal,'' provides other reasons that the actual market shares were higher than anticipated in HUD's 1995 estimates.

In accordance with FHEFSSA, HUD has re-estimated the market shares of the mortgages in the primary conventional market that would qualify for each of the GSEs' housing goals for the years 2000 through 2003.[53] HUD estimates that for the years 2000 through 2003 the low- and moderate-income share of the conventional market will be 50–55 percent, the underserved (geographically targeted) areas share of the market will be 29–32 percent, and the special affordable share will be 23–26 percent. Appendix D, ''Estimating the Size of the Conventional Conforming Market for Each Housing Goal,'' provides an extensive analysis of the Department's market share estimates.

The higher market estimates suggest that the gaps between the current goal levels and the market estimates of the opportunities available to the GSEs are wider than was anticipated in 1995. As with the 1995 estimates, these new market estimates also allow for more adverse economic conditions than recently experienced. For example, the lower end—50 percent—of the range for the low- and moderate-income market estimate is consistent with low- and moderate-income borrowers accounting for 35 percent of home purchase loans in the single-family owner market. (The remainder of the low- and moderate-income market share estimate includes multifamily and single family rental properties.) Since the 1992–98 average for the low- and moderate-income share of the home purchase market was 41 percent, and the more recent 1995–1998 average was 42 percent, some leeway is allowed for more adverse income and interest rate conditions. Such leeway may be needed since it is possible that the affordable housing market may not continue at current rates, particularly if there is a slowdown in economic activity.

While the single family affordable market has not changed substantially since 1995 when HUD developed its first market estimates, HUD has revised its new market estimates upward based upon its analyses of the underlying strength of the single family affordable market. That market has been consistently strong for the past six years (1993–1998). When HUD produced the market estimates in 1995, the data was limited to the early 1990s, during which 1993 and 1994 demonstrated the strongest affordable housing markets. Now, with four additional years (1995 to 1998) of data indicating consistent trends in the affordable market, HUD is more confident about the underlying strength of this market.

At the same time, HUD has used assumptions about future economic and market conditions that are more conservative than those that have actually prevailed over the last six years. HUD is well aware of the volatility of mortgage markets and their possible impacts on the GSEs' ability to meet the housing goals. HUD's market estimates have also changed to a small extent by including manufactured housing loans in the single family owner market, and slightly increasing the affordability and underserved area parameters for rental housing.

Under HUD's current regulations, the current levels of the housing goals remain in effect in 2000 and thereafter until such time as the Department establishes new annual housing goals. In this rule, HUD is proposing to establish new levels for the three housing goals and for the special affordable multifamily housing subgoal for the years 2000 through 2003. The housing goals as proposed would be phased in beginning in calendar year 2000 and would be fully in place in calendar years 2001, 2002 and 2003. In proposing the level of the housing goals for 2000 and thereafter, HUD has applied the statutory factors and also has concluded that the goals should be set far enough into the future to allow the GSEs to engage in long-term planning.

2. *Section 81.12 Low- and Moderate-Income Housing Goal.* This section discusses the Department's consideration of all the statutory factors in arriving at its proposed new housing goal level for the Low- and Moderate-Income Housing Goal. Additional information analyzing each of the statutory factors is provided in Appendix A, ''Departmental Considerations to Establish the Low- and Moderate-Income Housing Goal,'' and Appendix D, ''Estimating the Size of the Conventional Conforming Market for each Housing Goal.''

a. *Definition.* The Low- and Moderate-Income Housing Goal counts mortgages on housing for families with incomes not in excess of area median incomes.

b. *Market Estimate for the Low- and Moderate Income Housing Goal in 2000.* The Department estimates that dwelling units serving low- and moderate-income families will account for 50–55 percent of total units financed in the overall conventional conforming mortgage market during the period 2000 through 2003. Due to inherent uncertainty about future market conditions, HUD has developed a plausible range, rather than a point estimate, for the market. The detailed analyses underlying this estimate are presented in Appendix D, ''Estimating the Size of the Conventional Conforming Market for Each Housing Goal.''

c. *Past Performance of the GSEs Under the Low- and Moderate-Income Housing Goal.* HUD's current goals specified that in 1996 at least 40 percent of the number of units financed by mortgage purchases of the GSEs and eligible to count toward the Low- and Moderate-Income Goal should qualify as low- and moderate-income, and at least 42 percent should qualify in each year from 1997 through 1999. Fannie Mae surpassed these goal levels by 5.6 percentage points in 1996, 3.7 percentage points in 1997, and 2.1 percentage points in 1998. Freddie Mac surpassed the goals by 1.1 percentage points, 0.6 percentage point and 0.9 percentage point in 1996, 1997 and 1998, respectively. The GSEs' performance under the Low- and Moderate-Income Housing Goal for the 1996 through 1998 period is summarized below:

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[53] The goal-qualifying market shares are estimated for the years 2000–2003 under several projections about the relative sizes of the single family and multifamily markets. Numerous sensitivity analyses that consider alternative market and economic conditions are examined in Appendix D.

SUMMARY OF GSE PERFORMANCE UNDER THE LOW- AND MODERATE-INCOME HOUSING GOAL[1]

	1996	1997	1998
Required Goal Level	40%	42%	42%
Fannie Mae:			
Percent Low-and Moderate-Income	45.6%	45.7%	44.1%
Freddie Mac:			
Percent Low-and Moderate-Income	41.1%	42.6%	42.9%

1 The figures presented for goal performance are based on HUD analysis of the GSEs' loan level data. Some results differ marginally from the corresponding figures presented by Fannie Mae and Freddie Mac in their respective Annual Housing Activities Reports (AHARs) to HUD, reflecting differences in application of counting rules.

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During the transition period from 1993 through 1995, Fannie Mae's performance under the Low- and Moderate-Income Housing Goal jumped sharply in one year, from 34.2 percent in 1993 to 44.8 percent in 1994, before tailing off to 42.3 percent in 1995. It then stabilized at just over 45 percent in 1996 and 1997. Fannie Mae's performance in 1998 declined to 44.1 percent due in large measure to the high volume of refinance loans that Fannie Mae funded in 1998.

During the transition period, Freddie Mac demonstrated steadier gains in performance under the Low- and Moderate-Income Housing Goal, from 29.7 percent in 1993 to 37.4 percent in 1994 and 38.9 percent in 1995. Freddie Mac then achieved 41.1 percent in 1996, and 42.6 percent and 42.9 percent in 1997 and 1998, respectively. Fannie Mae's performance on the Low- and Moderate-Income Housing Goal has surpassed Freddie Mac's in every year. Nonetheless, Freddie Mac's 1998 performance represented a 44 percent increase over its 1993 level, exceeding the 29 percent increase for Fannie Mae. Freddie Mac's performance was 97 percent of Fannie Mae's low- and moderate-income share in 1998, the highest ratio since the goals took effect in 1993. Freddie Mac's improved performance is due mainly to its increased purchases of multifamily loans as it has become more active in this market. Some housing industry observers believe that the Low- and Moderate-Income Housing Goal has been an important factor explaining Freddie Mac's re-entry into the multifamily market.

In fact, multifamily purchases represent a significant component of both GSEs' activities in meeting the Low- and Moderate-Income Housing Goal, even though multifamily loans comprise a relatively small portion of the GSEs' business activities. In 1997, while Fannie Mae's multifamily purchases represented only 13.4 percent of its total acquisition volume measured in terms of dwelling units, these purchases comprised 26.7 percent of units qualifying for the Low- and Moderate-Income Housing Goal. Multifamily purchases were 8.2 percent of the units financed by Freddie Mac's 1997 mortgage purchases but were 19 percent of Freddie Mac's low- and moderate-income mortgage purchases.

The GSEs' 1998 performance took place in the context of a record level of mortgage originations, with unusually high refinance volume reaching 50 percent of single family mortgage originations. The GSEs relied upon a record volume of multifamily mortgage purchases in 1998—$12.5 billion for Fannie Mae and $6.6 billion for Freddie Mac—to exceed the 42 percent goal.

d. *Proposed Goal Levels for 2000–2003.* Having considered all statutory factors including housing needs, projected economic and demographic conditions for 2000 to 2003, the GSEs' past performance, the size of the market serving low- and moderate-income families, and the GSEs' ability to lead the market while maintaining a sound financial condition; HUD is proposing that the annual goal for mortgage purchases qualifying under the Low- and Moderate-Income Housing Goal be 48 percent of eligible units financed in calendar year 2000, and 50 percent of eligible units financed in each of calendar years 2001, 2002 and 2003. This proposed goal level is intended to increase the GSEs' current level of performance to a level that is consistent with reasonable estimates of the low- and moderate-income housing market. HUD's detailed findings under the statutory factors for establishing the goal are described in Appendix A, ''Departmental Considerations to Establish the Low- and Moderate-Income Housing Goal,'' and Appendix D, ''Estimating the Size of the Conventional Conforming Market for Each Housing Goal.''

3. *Section 81.13—Central Cities, Rural Areas, and Other Underserved Areas Housing Goal.* This section discusses the Department's consideration of all the statutory factors in arriving at its proposed new housing goal level for the Central Cities, Rural Areas, and Other Underserved Areas Housing Goal (the Geographically Targeted Goal). Additional information analyzing each of the statutory factors is provided in Appendix B, ''Departmental Considerations to Establish the Central Cities, Rural Areas, and Other Underserved Areas Goal,'' and Appendix D, ''Estimating the Size of the Conventional Conforming Market for Each Housing Goal.'' This section also discusses possible changes being considered to the definition of underserved areas.

a. *Definition.* The Geographically Targeted Goal focuses on areas currently underserved by the mortgage finance system. The 1995 Final Rule provides that for properties in metropolitan areas, mortgage purchases count toward the Geographically Targeted Goal if such purchases finance properties that are located in underserved census tracts. In § 81.2, HUD defined ''underserved areas'' as areas where either: (1) The tract median income is at or below 90 percent of the area median income (AMI); or (2) the minority population is at least 30 percent and the tract median income is at or below 120 percent of AMI. The AMI ratio is calculated by dividing the tract median income by the MSA median income. The minority percent of a tract's population is calculated by dividing the tract's minority population by its total population.

For properties in non-metropolitan (rural) areas, mortgage purchases count toward the Geographically Targeted Goal where such purchases finance properties that are located in underserved counties. These are defined as counties where either (1) the median income in the county does not exceed 95 percent of the greater of the state or nationwide non-metropolitan median income; or (2) minorities comprise at least 30 percent of the residents and the median income in the county does not exceed 120 percent of the state non-metropolitan median income.

b. *Market Estimate for the Geographically Targeted Goal.* The Department estimates that dwelling units in underserved areas will account for 29–32 percent of total units financed in the overall conventional conforming mortgage market during the period 2000 through 2003. Due to inherent uncertainty about future market conditions, HUD has developed a plausible range, rather than a point estimate, for the market. The detailed analyses underlying this estimate are presented in Appendix D, ''Estimating the Size of the Conventional Conforming Market for Each Housing Goal.''

c. *Past Performance of the GSEs Under the Geographically Targeted Goal.* HUD's goals specified that in 1996 at least 21 percent of the units financed by the GSEs' mortgage purchases should count toward the Geographically Targeted Goal, and at least 24 percent in 1997 through 1999. Fannie Mae surpassed the goal by 7.1 percentage points in 1996, 4.8 percentage points in 1997, and 3.0 percentage points in 1998. Freddie Mac surpassed the goal by 4.0, 2.3 and 2.1 percentage points in 1996, 1997 and 1998, respectively. The GSEs' performance for the 1996–98 period is summarized below:

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SUMMARY OF GSE PERFORMANCE UNDER THE THE GEOGRAPHICALLY TARGETED GOAL[1]

	1996	1997	1998
Required Goal Level	21%	24%	24%
Fannie Mae:			
Percent Geographically Targeted	28.1%	28.8%	27.0%
Freddie Mac:			
Percent Geographically Targeted	25.0%	26.3%	26.1%

1 The figures presented for goal performance are based on HUD's analysis of the GSEs' loan level data. Some results differ marginally from the corresponding figures presented by Fannie Mae and Freddie Mac in its AHARs, reflecting differences in application of counting rules.

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Although both GSEs have improved their performance in underserved areas, on average, their mortgage purchases continue to lag the primary market in providing financing for affordable loans in underserved neighborhoods. During the 1996–1998 period, underserved areas accounted for 19.9 percent of Freddie Macs purchases of single family home mortgages compared with 22.9 percent of Fannie Mae's purchases, 25.8 percent of mortgages retained by portfolio lenders, and 24.9 percent of all home purchase mortgages originated in the conventional conforming market. As these figures indicate, Freddie Mac has been less likely than Fannie Mae to purchase mortgages on properties in underserved neighborhoods. Freddie Mac has not made progress in reducing the gap between its performance and that of the overall market. In 1992, underserved areas accounted for 18.6 percent of Freddie Mac's purchases of home purchase mortgages and for 22.2 percent of home loans originated in the conforming market, which yields a ''Freddie Mac-to-Market'' ratio [54] of 0.84 percent. By 1998, the ''Freddie Mac-to-Market'' ratio had actually fallen to 0.81 percent. During the same period, the ''Fannie Mae-to-Market'' ratio increased from 0.82 percent to 0.93 percent.

Fannie Mae's performance under this goal improved due to its increased purchases during 1997 and 1998 of mortgages originated in prior years in underserved neighborhoods. For instance, Fannie Mae's purchases of single family home mortgage loans in underserved areas increased from 22.3 percent in 1996 to 23.5 percent in 1997. However, the percentage of Fannie Mae's purchases of newly originated mortgages on dwellings in underserved areas was lower in 1997 (20.8 percent) than in 1996 (21.9 percent). This decline was offset by the fact that a high percentage (30.1 percent) of Fannie Mae's purchases in 1997 of prior year mortgages were home mortgage loans on properties in underserved areas. This focus on prior year mortgages explains why Fannie Mae's performance increased across several affordable lending categories between 1996 and 1997. Fannie Mae's purchases of prior year affordable housing loans continued in 1998.

In evaluating the GSEs' past performance, it should be noted that while borrowers in underserved metropolitan areas tend to have much lower incomes than borrowers in other areas, this does not mean that GSE purchase activity in underserved areas derives totally from lower income families. In 1997, above median-income households accounted for 37 percent of the mortgages the GSEs purchased in underserved areas.

d. *Proposed Goal Levels for 2000–2003.* Having considered all statutory factors including housing needs, projected economic and demographic conditions for 2000 to 2003, the GSEs' past performance, the size of the market for central cities, rural areas and other underserved areas, and the GSEs' ability to lead the market while maintaining a sound financial condition; HUD is proposing that the annual goal for mortgage purchases qualifying under the Geographically Targeted Goal be 29 percent of eligible units financed in calendar year 2000, and 31 percent of eligible units financed in each of calendar years 2001, 2002 and 2003. This proposed goal level is intended to increase the GSEs' current level of performance to a level that is consistent with reasonable estimates of the housing market in underserved areas. The Department's detailed findings under the statutory factors for establishing the goal are described in Appendix B, ''Departmental Considerations to Establish the Central Cities, Rural Areas, and Other Underserved Areas Goal,'' and Appendix D, ''Estimating the Size of the Conventional Conforming Market for Each Housing Goal.''

e. *Proposed Definitional Changes for Underserved Areas.* (1) Metropolitan Areas. The Department is seeking comments on possible changes to the current metropolitan underserved areas definition in an effort to more accurately target underserved areas with higher mortgage denial rates and thereby promote access to mortgage credit nationwide. Specifically, HUD is considering changing the current tract income ratio to an ''enhanced'' tract income ratio and requiring that for tracts to qualify they must have an enhanced tract income ratio at or below 80 percent of area median income. The enhanced tract income ratio described below would make the underserved areas definition used by the GSEs consistent with the requirements of Federally insured depository institutions under the Community Reinvestment Act (CRA).

The ''enhanced'' option is two-fold. First, it would change the tract income ratio (described in the definition of ''central city'' or ''other underserved area'' in paragraph (1) of the definition of ''Underserved areas'' in § 81.2) from one that is calculated using MSA median income to one that is based on the greater of either the national metropolitan median income or the MSA median income. This approach would ensure that low-income census tracts in low-income MSAs are classified as underserved. With this change, 994 tracts, with an average mortgage denial rate of 26.8 percent, would be added to the scope of the current definition.

Second, the enhanced option would change the level of the income ratio required in paragraph (1)(ii) of the definition of ''Underserved areas.'' Tracts would qualify as underserved if their income ratio were 80 percent as compared to a tract income ratio of 90 percent under the current definition. With this change, 2,500 tracts, with an average mortgage denial rate of 17.8 percent, would be dropped from the scope of the current definition. Of the tracts that would be dropped, the mortgage denial rate is not much higher than the average mortgage denial rate for all metropolitan areas, which is 15.3 percent. This suggests that these areas are not experiencing severe problems in obtaining mortgage credit and should not be targeted. The overall number of tracts that would qualify with both parts of the enhanced option is 20,093, with an average mortgage denial rate of 25.0 percent.

Although the Department preliminarily favors adopting a definitional change based on the enhanced tract income option described above, another approach to targeting high mortgage denial areas is to increase the alternative requirement for an underserved area by increasing the minority concentration required from the current 30 percent to 50 percent. Adopting this option would exclude many tracts with high mortgage denial rates. This option would drop 1,045 tracts with a relatively high mortgage denial rate of 20.2 percent. Nevertheless, this proposal should stimulate conventional lending in high minority neighborhoods that have been traditionally underserved.

Either of the possible changes to the existing definition for underserved areas would likely affect the estimated market share for the Geographically Targeted Goal. If either of the possible changes were adopted, the Department would revise its market estimates of underserved areas accordingly and the level of the housing goal as needed to reflect the revised estimates.

HUD seeks comment on the proposed options for revising the definition of underserved metropolitan areas, including the extent to which these definitional changes are likely to increase the availability of credit to areas with high mortgage denial rates.

[54] GSE to market ratio is calculated by dividing the performance of the respective GSE by the performance of the market.

(2) Tribal Lands. In reviewing the criteria for underserved areas, HUD believes that difficulties in obtaining mortgage loans on qualifying American Indian Reservations and trust lands deserve attention. A February 1998 report by the General Accounting Office (GAO) concerning lending on tribal lands found that, during a five year period from 1992 through 1996, only 91 conventional home purchase loans were made to Native Americans on trust lands.[55] The eight lenders making these loans held all of them in portfolio. In addition, government-backed loans were insured by HUD under its Section 184 and Section 248 programs which promote affordable housing opportunities for Native American families, and through programs of the Department of Veterans Affairs, the U.S. Department of Agriculture, and the Federal Home Loan Banks. Fannie Mae has consistently purchased Section 184 loans, and Freddie Mac has recently become involved in this program.

A number of reservations cross county and census tract lines with a portion of the reservation in a county that is otherwise considered high-income and/or low-minority and a portion of the reservation in a county that is neither. Part of a reservation, therefore, may be considered an underserved area and part a served area. To remedy such anomalies, this rule proposes that reservations and trust lands would be considered separate geographic entities rather than parts of the counties in which they are located. Thus, in a non-metropolitan area, median income for the reservation would be compared with state (or national) non-metropolitan median income in determining whether the reservation is an ''underserved area;'' and in a metropolitan area, median income for the reservation would be compared with the median income of the respective metropolitan area.

HUD has determined that currently 173 non-metropolitan counties that contain Indian reservations or trust lands are classified as underserved areas and 88 such counties are classified as served areas. In metropolitan areas, 131 census tracts that contain Indian reservations or trust lands are currently classified as underserved areas and 115 such tract are classified as served areas. Inclusion of qualifying Indian reservations and trust lands in these 88 counties and 115 census tracts as underserved areas in calculating the Geographically Targeted Goal would not automatically be expected to have a major impact on lending in these areas, at least initially, but it could heighten awareness and encourage future growth in conventional mortgage lending to these areas.

Based on this analysis, the Department proposes to revise § 81.2 to designate all qualifying Indian reservations and trust lands as underserved areas.

(3) Rural Areas. The current definition of underserved non-metropolitan or rural areas under the Geographically Targeted Goal accounts for 53 percent of the households, 57 percent of the census tracts, and 66 percent of the counties in rural areas. Unlike the underserved definition for metropolitan areas, which is based on the minority or low-income concentration of census tracts, the non-metropolitan/rural underserved definition is based on these criteria for counties. During the 1995 rulemaking process, experts on rural lending informed HUD that lenders' business operations in rural areas are oriented toward counties, not census tracts. In addition, counties are easy to identify and geocode, which facilitates the reporting process for lenders who provide the GSEs with loan-level data on mortgages. However, HUD recognized then, and experience has borne out, that, under its county-based definition, the GSEs can achieve the goal by purchasing mortgages located in the parts of underserved counties that have higher incomes.

The broad nature of the underserved definition for non-metropolitan areas raises at least two concerns. The first concern is that the broad definition appears to result in similar borrower characteristics in served and underserved counties. HUD's analysis indicates that the GSEs are less likely to purchase loans for first-time homebuyers and more likely to purchase mortgages for high-income borrowers in underserved than in served counties. Mortgages to first-time homebuyers account for 13.9 percent of the GSEs' mortgage purchases in served counties compared with 12.3 percent in underserved counties. Interestingly, it is more likely for borrowers in underserved counties (71.2 percent) to have incomes above the county median than in served counties (65.5 percent). These findings support the claim that, in rural underserved counties, the GSEs purchase mortgages of borrowers who probably encounter few obstacles to obtaining mortgage credit. Further, mortgages purchased by the GSEs in underserved areas do not have low down payments. In both served and underserved counties, only 27 percent of the GSEs' mortgage purchases have loan-to-value ratios above 80 percent.

Defining underserved areas in terms of an entire county also appears to encourage the GSEs to purchase mortgages in the more affluent tracts. HUD's analysis shows that even though the GSEs purchase a greater percentage of mortgages in high-minority and low-income tracts in underserved than in served counties, they purchase nearly the same percentage of mortgages in both underserved and served counties in high-income tracts. In underserved counties, 12.3 percent of the GSEs' mortgage purchases are in tracts above 120 percent area median income compared with 14.6 percent in served counties.

There are few conclusive studies on access to mortgage credit in rural areas, and the studies that do exist suggest only broad conclusions about credit flows in these areas. Moreover, evaluating which rural locations are underserved in terms of access to mortgage credit cannot be done with HMDA data on which HUD mainly relied in defining urban underserved areas. Other data bases available with mortgage market information have similar limitations with regard to coverage of mortgage activity in rural areas. Nonetheless, based on an analysis of the GSEs' mortgage purchases by tract median income, it does not appear that the current county definition is encouraging the GSEs to target their mortgage purchases to the most underserved portions of rural areas.

For these reasons, the Department is seeking public comment on alternative methodologies and sources of rural market data that HUD might use to define underserved non-metropolitan/rural areas. Specifically, HUD seeks comment on whether the Department should follow a tract-based approach in defining underserved rural areas, which would be consistent with the tract-based definition used in metropolitan areas. As technology and computer mapping capabilities have evolved since 1995, it may be appropriate to revisit the issue of whether entire counties or census tracts within the counties should be used to define rural underserved areas.

4. *Section 81.14 Special Affordable Housing Goal.* This section discusses the Department's consideration of all the statutory factors in arriving at its proposed new housing goal level for the Special Affordable Housing Goal. Additional information analyzing each of the statutory factors is provided in Appendix C, ''Departmental Considerations to Establish the Special Affordable Housing Goal,'' and Appendix D, ''Estimating the Size of the Conventional Conforming Market for Each Housing Goal.'' This section also

[55] GAO/RCED–98–49.

discusses possible changes being considered to the structure of the multifamily subgoal.

a. *Definition.* The Special Affordable Housing Goal targets mortgages on housing for very low-income families and low-income families living in low-income areas. Units that count toward the Special Affordable Housing Goal include units occupied by low-income owners and renters in low-income areas, and very-low-income owners and renters. In addition, low-income rental units in multifamily properties in which at least 20 percent of the units are affordable to families whose incomes are 50 percent of area median income, or less, or where at least 40 percent of the units are affordable to families whose incomes are 60 percent area median income, or less, count toward the goal.

b. *Market Estimate for the Special Affordable Housing Goal.* The Department estimates that dwelling units serving very low-income families and low-income families living in low-income areas will account for 23–26 percent of total units financed in the overall conventional conforming mortgage market during the period 2000 through 2003. Due to inherent uncertainty about future market conditions, HUD has developed a plausible range, rather than a point estimate, for this market. The detailed analyses underlying this estimate are presented in Appendix D, ''Estimating the Size of the Conventional Conforming Market for Each Housing Goal.''

c. *Past Performance of the GSEs' Under the Special Affordable Housing Goal.* The Special Affordable Housing Goal is designed to ensure that the GSEs consistently focus on serving the very low-and low-income portion of the housing market. However, analysis of American Housing Survey and HMDA data show that the shares of mortgage loans for very low-income homebuyers are smaller for the GSEs' mortgage purchases than for depository institutions and others originating mortgage loans in the conforming conventional market. HUD's analysis suggests that the GSEs should improve their performance in providing financing for the very low-income housing market.

HUD's goals specified that in 1996 at least 12 percent of the number of units eligible to count toward the Special Affordable Housing Goal should qualify as special affordable, and at least 14 percent in 1997 through 1999. As indicated below, Fannie Mae surpassed the goal by 3.4 percentage points in 1996, 3.0 percentage points in 1997 and 0.3 percentage point in 1998. Freddie Mac surpassed the goal by 2.0, 1.2, and 1.9 percentage points in 1996, 1997 and 1998, respectively. The GSEs' performance for the 1996–95 period is summarized below:

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SUMMARY OF GSE PERFORMANCE UNDER THE SPECIAL AFFORDABLE HOUSING GOAL[1]

	1996	1997	1998
Required Goal Level	12%	14%	14%
Fannie Mae:			
Special Affordable Housing Goal	15.4%	17.0%	14.3%
Freddie Mac:			
Special Affordable Housing Goal	14.0%	15.2%	15.9%

[1] The figures presented for goal performance are based on HUD's analysis of the GSEs' loan level data. Some results differ from the corresponding figures presented by Fannie Mae in its AHARs by one to two percentage points. The difference largely reflects differences between HUD and Fannie Mae in application of counting rules relating to counting of seasoned mortgage loans for purposes of this goal. Freddie Mac's AHAR figures for this goal differ marginally from the official figures presented above, also reflecting differences in application of counting rules.

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HMDA and GSE data for metropolitan areas show that both GSEs lag depository institutions and other lenders in providing financing for home loans that qualify for the Special Affordable Housing Goal. Special affordable loans, which include loans for very low-income borrowers and low-income borrowers living in low-income areas, accounted for 9.8 percent of Freddie Mac's purchases of home purchase mortgages during 1996–98, 11.9 percent of Fannie Mae's purchases, 16.7 percent of newly originated loans retained by depository institutions, and 15.3 percent of all new originations in the conventional conforming market. While Freddie Mac has improved its special affordable lending over the past few years, it has not made as much progress as Fannie Mae in closing the gap with depository institutions and other lenders in the home loan market. In 1998, Freddie Mac's special affordable performance was 73 percent of the primary market proportion of home loans that would qualify under the Special Affordable Housing Goal, compared to Fannie Mae's performance of 85 percent during the same period.

The multifamily market is especially important in the establishment of the Special Affordable Housing Goal for Fannie Mae and Freddie Mac because of the relatively high percentage of multifamily units meeting the Special Affordable Housing Goal. In 1997, 57 percent of units financed by Freddie Mac's multifamily mortgage purchases met the Special Affordable Housing Goal, representing 31 percent of units counted toward its Special Affordable Housing Goal, at a time when multifamily units represented only eight percent of its total purchase volume. Corresponding percentages for Fannie Mae's multifamily purchases were: 54 percent of units financed by Fannie Mae's multifamily mortgage purchases met the Special Affordable Goal, multifamily units represented 44 percent of units meeting the Special Affordable Goal but only 13 percent of total purchase volume. In comparison, HUD estimates that multifamily mortgages accounted for 20 percent of the total number of dwelling units financed in the conventional conforming market in 1997.

d. *Proposed Goal Levels for 2000–2003.* Having considered all statutory factors including housing needs, projected economic and demographic conditions for 2000 to 2003, the GSEs' past performance, the size of the market serving very low-income families and low-income families living in low-income areas, and the GSEs' ability to lead the market while maintaining a sound financial condition; HUD is proposing that the annual goal for mortgage purchases qualifying under the Special Affordable Housing Goal be 18 percent of eligible units financed in calendar year 2000, and 20 percent of eligible units financed in each of calendar years 2001, 2002 and 2003. This proposed goal level is intended to increase the GSEs' current level of performance to a level that is consistent with reasonable estimates of the special affordable housing market. The Department's detailed findings under the statutory factors for establishing the goal are described in Appendix C, ''Departmental Considerations to Establish the Special Affordable Housing Goal,'' and Appendix D, ''Estimating the Size of the Conventional Conforming Market for Each Housing Goal.''

e. *The Multifamily Subgoal.* Under the Special Affordable Housing Goal, HUD established a subgoal for purchases of multifamily mortgages. HUD established this subgoal at 0.8 percent of the dollar value of each GSE's respective 1994 dollar purchase volume, including both single family and multifamily mortgage purchases. This yielded subgoals of $988 million for Freddie Mac and $1.29 billion for Fannie Mae.[56]

Freddie Mac narrowly exceeded the subgoal in 1996 and 1997, with multifamily special affordable acquisitions of $1.1 billion and $1.2 billion, respectively. Freddie Mac exceeded the goal by a wider margin in 1998, when it purchased $2.7 billion in multifamily special affordable loans. Fannie Mae has consistently surpassed its multifamily subgoal, with multifamily mortgage purchases of $2.4 billion in 1996, $3.2 billion in 1997, and $3.5 billion in 1998.[57]

Approximately half of the GSEs' annual multifamily purchase volume usually qualifies toward the Special Affordable Housing Goal. Moreover, multifamily acquisitions typically represent a significant proportion of all GSE purchases qualifying toward the Special Affordable Housing Goal. As noted earlier, multifamily acquisitions contributed 44.0 percent of units qualifying toward Fannie Mae's Special Affordable Housing Goal, with a corresponding figure of 31.4 percent for Freddie Mac.

One of the Department's principal objectives in establishing the subgoal was to ensure Freddie Mac's re-entry into the multifamily market. In 1991–1993, following losses on multifamily mortgage loans, Freddie Mac had virtually no multifamily mortgage purchase capacity. Over the past five years, however, Freddie Mac has built new capacity to support its multifamily mortgage purchase activity and has expanded its presence in the multifamily financing market to the point that it purchased $6.6 billion of multifamily mortgages in 1998. Industry observers believe that the special affordable multifamily subgoal has contributed toward a significantly increased presence by Freddie Mac in the multifamily market.

Fannie Mae was well established in the multifamily mortgage market prior to the establishment of the multifamily special affordable subgoal. Fannie Mae's performance has consistently surpassed the subgoal by a wide margin, as noted above.

f. *Proposed Multifamily Subgoal Level.* The Secretary proposes to retain the special affordable multifamily subgoal for each of the calendar years for the period 2000 through 2003, and to increase the fixed minimum level to 0.9 percent of the dollar volume of combined (single family and multifamily) 1998 mortgage purchases in calendar year 2000, and 1.0 percent of the dollar volume of combined (single family and multifamily) 1998 mortgage purchases in each of calendar years 2001, 2002 and 2003. This approach is consistent with the approach taken under the current regulations.

The proposed subgoal would establish the following new annual thresholds for the two GSEs.[58]

	2000	2001–2003
Proposed Goal Levels	0.9 percent	1.0 percent.

[56] Mortgages that are backed by properties that include both special affordable and other units are counted by multiplying the acquisition unpaid principal balance by the number of units qualifying for the Special Affordable Housing Goal, divided by the total number of units.

[57] These figures are as determined by HUD based on its analysis of GSE loan-level data. They differ somewhat from figures reported by the GSE in their Annual Housing Activities Reports submitted annually to HUD due to differences in application of counting rules, and for other reasons.

[58] HUD has determined that the total dollar volume of the GSEs' combined (single and multifamily) mortgage purchases in 1998, measured in unpaid principal balance at acquisition, was as follows: Fannie Mae $367.589 million: Freddie Mac $273, 231 million.

	2000	2001–2003
Fannie Mae	$3.31 billion	$3.68 billion.
Freddie Mac	$2.46 billion	$2.73 billion.

The proposed subgoal levels can be compared with Fannie Mae's 1998 performance of $3.5 billion, and Freddie Mac's 1998 multifamily special affordable multifamily acquisition volume of $2.7 billion. A 1.0 percent dollar-based multifamily subgoal for 2001–2003 would sustain and likely increase the efforts of both GSEs in the multifamily mortgage market, with particular emphasis upon the special affordable segment.

g. *Alternative Approaches to Setting the Subgoal Level.* A possible consequence of the subgoal as proposed, however, is that, to the extent that the GSEs experience certain fixed transactions costs in each multifamily acquisition, they can attain the special affordable multifamily subgoal with the smallest possible transactions costs by purchasing multifamily mortgages with large unpaid principal balances that have a high proportion of units that qualify for the Special Affordable Housing Goal. This approach, therefore, could foster the GSEs' purchases of loans on large properties with more than 50 units, the market for which is already relatively liquid, at the expense of loans on smaller properties, a sector which has not benefited from same degree of exposure to secondary markets, as discussed in Appendix A. In order to provide incentives for a greater commitment by the GSEs in the market for mortgages on small multifamily properties with 5–50 units, the Department is proposing to award ''bonus points'' for purchases of such loans, as described below.

A further consequence of a dollar-based goal is that the number of mortgages the GSEs would be required to purchase under the subgoal, and the number of units in the associated properties, would both be expected to decrease over the goals period, due to the effects of inflation and an expected rise in property values over the period of years during which the subgoal is in effect. For example, the rise in multifamily property values over 1996–1998 contributed to an increase in per-unit loan amounts in the GSEs' multifamily special affordable purchases of approximately 15 percent, with a commensurate decrease in the number of units corresponding to the minimum dollar-based purchase volume required under the multifamily special affordable subgoal.

While this proposed rule specifically proposes a dollar-based subgoal, the Department is considering three alternative approaches to structuring the special affordable multifamily subgoal—a unit-based subgoal, a subgoal based on a percentage of multifamily acquisitions, and a mortgage-based subgoal. These approaches may be structured as outlined in the following options. Additional discussion of these subgoal options in relation to GSE past performance is contained in Appendix C.

(1) *Option One—Subgoal Based on Number of Units.* In this approach, the multifamily special affordable subgoal would be expressed as a minimum number of units meeting the Special Affordable Housing Goal. A multifamily subgoal for 2001–2003 established at the level of the dollar-based subgoal defined above, divided by $22,953, which is the average of Fannie Mae's and Freddie Mac's ratios of unpaid principal balance to the number of units in multifamily properties counted toward the Special Affordable Housing Goal in 1997 (as determined by HUD), would generate annual multifamily special affordable subgoals of 160,328 units per year for Fannie Mae and 118,939 units per year for Freddie Mac. Such a multifamily subgoal for 2001–2003 would sustain and likely increase the efforts of both GSEs in the multifamily mortgage market, with particular emphasis upon the special affordable segment.[59]

A unit-based subgoal would result in a greater level of affordability among the GSEs' special affordable purchases than does a dollar-based subgoal. This conclusion is based on GSE loan-level data which shows that the more affordable the unit, the smaller is the associated unpaid principal balance per unit. Therefore, a subgoal based on number of units provides the GSEs with an incentive to purchase mortgages on properties with relatively low loan amounts per unit and, as a result, relatively high affordability, as the least costly method of attaining the subgoal. This unit-based approach also avoids the problem associated with the effects of inflation discussed above in regard to the proposed dollar based subgoal.

However, this approach also has one of the same consequences as the proposed subgoal based on dollar volume of acquisitions, in that a GSE can attain such a subgoal with the smallest possible transactions costs by purchasing a few multifamily mortgage loans with large unpaid principal balances which have a high proportion of units qualifying for the Special Affordable Housing Goal. This approach, therefore, may foster the GSEs' purchase of loans on large multifamily properties, which are already relatively well served by the mortgage market, at the expense of loans on smaller properties.

(2) *Option Two—Subgoal As A Percent of GSEs' Current Multifamily Mortgage Purchases.* Another possible approach is to establish the special affordable multifamily subgoal as a minimum percentage of each GSE's current total dollar volume of multifamily mortgage purchases. For example, the subgoal level for 2001–2003 could be expressed as 58 percent of a GSE's multifamily dollar volume in 2001, 2002 and 2003, respectively.[60]

An advantage of expressing the subgoal in this manner is that it would be flexible, increasing and decreasing in a manner commensurate with the overall presence of the GSEs in the current-year multifamily market. It would not require a fixed quantity of units, or fluctuate based on the GSEs' involvement with the single-family market.

An operational disadvantage is that such a subgoal could undermine the GSEs' incentive to expand multifamily volume that has existed since 1994. For example, one of the GSEs, having met its special affordable multifamily subgoal by the end of the third quarter in a calendar year, could decide to withdraw from the multifamily market in the fourth quarter in order to avoid the possibility of not attaining the subgoal at the end of the year due to the uncertainty regarding the affordability characteristics of multifamily mortgages offered for sale during the remainder of the year. In order to mitigate any such disincentive effects, HUD could establish an ''alternative minimum'' subgoal floor based on dollar volume, units, or mortgages. However, this

[59] If this option were selected, appropriate subgoal thresholds for the one-year transition period (2000) could be developed along the lines of those proposed under the multifamily special affordable subgoal above.

[60] If this option were selected, appropriate subgoal thresholds for the one-year transition period (2000) could be developed.

would open the possibility that a GSE might choose to simply orient its multifamily business toward the required alternative minimum amount of multifamily mortgage purchases.

(3) *Option Three—Subgoal Based on Number of Mortgages Acquired.* Because the GSEs incur relatively large fixed costs in purchasing multifamily mortgage loans, another alternative to the Special Affordable Multifamily Housing Subgoal would be to establish a subgoal based on the number of mortgages acquired. In this approach, the Special Affordable multifamily subgoal would be expressed as a minimum number of each GSEs' total mortgage purchases. If all the units in the property securing the mortgage are not eligible for the Special Affordable Housing Goal, then subgoal performance would be pro-rated based on the number of qualifying units. In other words, if one mortgage secured a 100-unit property and 50 of the units qualified for the Special Affordable Housing Goal, then subgoal credit would be counted as one-half of a mortgage.[61]

A multifamily subgoal for 2001–2003 established at 0.035 percent of the number of mortgages acquired by each of the GSEs in 1998 (as determined by HUD) would generate annual subgoals of 1,129 multifamily special affordable mortgages for Fannie Mae and 854 for Freddie Mac.[62] A 0.035 percent mortgage-based multifamily subgoal for 2001–2003 would sustain and likely increase the efforts of both GSEs in the multifamily mortgage market, with particular emphasis upon the special affordable segment.[63]

As noted previously, the GSEs incur relatively large fixed costs when underwriting and purchasing multifamily mortgage loans. As a result, there could be an incentive to purchase large multifamily mortgage loans to reduce the cost of the transactions per unit. Under this approach to the special affordable multifamily subgoal utilizing the number of mortgages acquired as the benchmark, the GSEs would have additional incentive to choose a large pool of small loans over a pool consisting of a few large loans.[64] This could facilitate liquidity in the market for mortgages on small multifamily properties where there continues to be unmet credit needs. Because multifamily mortgage purchases are an important source of affordable housing and contribute significantly to meeting the unit based housing goals, the GSEs also would be expected to continue to purchase mortgages secured by larger properties.

This approach also avoids the problem associated with the effects of inflation, discussed above, in regard to the proposed dollar-based subgoal. The magnitude of the goal is independent of the loan amount per unit.

However, while a mortgage-based approach to the subgoal may address the small multifamily rental property issue, it may not have the same impact in financing as many units overall as other approaches.

(4) *Comments Sought.* The Department seeks comment on whether the special affordable multifamily subgoal proposed that is based on a percentage of total dollar volume of mortgages purchased, or the possible alternative structures presented that base the subgoal on (a) the number of units financed, (b) a percent of current multifamily mortgage purchases, or (c) the number of mortgages acquired, are reasonable and desirable approaches to closing market gaps in the very low-and low-income rental market. HUD also solicits comment on the appropriate level for the subgoal as proposed, or under the various possible structures presented, and how the possible levels illustrated herein would likely impact multifamily acquisitions, especially for very low-and low-income multifamily units.

5. *Bonus Points and Subgoals.* Although the GSEs have been successful in meeting their housing goals, analyses of their housing goal performance and market needs indicate that certain credit gaps remain. For example, HUD's analysis reveals that the need for mortgage credit persists in specific markets that focus on lower-income families including small multifamily rental properties; single family, owner-occupied rental properties (2–4 units); manufactured housing; multifamily properties in need of rehabilitation; and properties in tribal areas. As a regulatory incentive to encourage the GSEs to increase their mortgage purchase activity in these underserved markets, the Department is proposing the use of bonus points in certain important segments of the housing market. HUD also seeks comments on the utility of applying similar regulatory incentives (bonus points and/or subgoals) to other underserved segments.

a. *Bonus Points.* Section 1336(a)(2) of FHEFSSA directs the Department to ''establish guidelines to measure the extent of compliance with the housing goals, which may assign full credit, partial credit, or no credit toward achievement of the housing goals to different categories of mortgage purchase activities of the enterprises, based on such criteria as the Department deems appropriate.'' This provision confers broad authority upon HUD to assign varying levels of credit to differing types of mortgage purchases. Under this and other authorities, HUD may offer bonus points for particular categories of mortgage purchase transactions.

The Department proposes to introduce a system of bonus points to encourage the GSEs to increase their activity in underserved markets that serve lower-income families. The intent of bonus points is to encourage increased involvement by the GSEs over the 2000–2003 period in financing mortgages on small multifamily properties and mortgages on 2–4 unit owner-occupied properties that contain rental units, for which the GSEs' mortgage purchases have traditionally played a minor role.

Bonus points would be used in calculating goal performance under each of the affordable housing goals but would not apply in determining performance under the special affordable housing multifamily subgoal. All units counting toward a specific housing goal and, thus, included in the numerator of the fraction used to calculate goal performance under that particular housing goal would be eligible for bonus points provided that the units met the specific criteria for allowable bonus points. This provision would apply to all units included in the numerator even if a unit were missing affordability data and the missing affordability data were treated consistent with the proposal included in the following section II,B,6,b, ''Data on Unit Affordability.''

(1) *Bonus Point Proposal for Small Multifamily Properties.* HUD proposes to add § 81.16(c)(10)(1) to provide for the assignment of double weight in the numerator for each of the three housing

[61] A similar pro-rating technique is specified for the special affordable multifamily subgoal in the 1995 Final Rule. See footnote 62.

[62] HUD has determined that the number of mortgage loans purchased by the GSEs in 1998 was as follows:

Fannie Mae: 3,226,786.

Freddie Mac: 2,439,194.

[63] If this option were selected, appropriate subgoal thresholds for the one-year transition period (2000) could be developed.

[64] For example, under this subgoal option, the purchase of a mortgage backed by a 10-unit property with $300,000 mortgage would receive the same subgoal credit as a 100-unit property with a $2.5 million mortgage (provided all units were eligible for the Special Affordable Housing Goal). If all the units in the property securing the mortgage are not eligible for the Special Affordable Housing Goal, then subgoal performance would be pro-rated based on the number of qualifying units, as discussed above.

goals for units in small multifamily properties (5 to 50 units) that qualify under the goals. The GSEs purchase relatively few of these loans. Over the 1996–98 period, only eight percent of the units represented in the combined multifamily purchases of Fannie Mae and Freddie Mac were in properties in the 5–50 unit size range, compared to 37 percent of units which are in 5–50 unit properties among all mortgaged multifamily properties in 1991 (based on the Residential Finance Survey). Loans of this type which are not purchased by the GSEs are often structured with adjustable-rate mortgages, or with fixed-rate financing involving interest rates that are as much as 150 basis points above those on standard multifamily loans. Targeting the GSEs toward these purchases could make these properties and the units in them more available and affordable.

Awarding bonus points for these units would have increased Fannie Mae's and Freddie Mac's performance on the Low- and Moderate-Income Housing Goal by an average of 0.89 and 0.33 percentage points, respectively, over the 1996–98 period. Corresponding percentage point effects for the Special Affordable Housing Goal are 0.55 and 0.21 percentage points, and for the Geographically Targeted Goal, 0.66 and 0.21 percentage points for Fannie Mae and Freddie Mac, respectively. The impacts could be significantly larger in future years if such a bonus point framework provided a significant incentive for the GSEs to step up their role in financing small multifamily properties.

(2) *Counting Units in Small Multifamily Properties.* Implementing this provision would require clear specification of the concept of a multifamily property relative to which the 5–50 unit limit for bonus points would be applied. The Department proposes to award bonus points for small multifamily properties to address the significant needs for their financing, both for properties that are underwritten and financed individually and for properties that are aggregated into larger financing packages. However, the Department further intends that bonus points will not be awarded for properties that are aggregated or disaggregated into 5–50 unit financing packages solely for the purpose of earning bonus points. Normally, a property is the land and improvements associated with one mortgage as defined in HUD's regulations. Ambiguity may arise in connection with GSE financings which are not cash or swap transactions involving mortgages. In such cases, or in other cases where a GSE believes that it would be appropriate to award bonus points in connection with a transaction, the GSEs should seek guidance from the Department concerning the delineation of properties associated with the financing and the consequent allowability of bonus points.

(3) *Bonus Points for Small Rental Properties.* HUD further proposes to add § 81.16(c)(10)(ii) to assign double weight in the numerator for each of the three housing goals for all units in 2- to 4-unit owner-occupied properties that qualify under the goals. Under this proposal, such units would receive bonus-point treatment to the extent that the number of such units financed by mortgage purchases are in excess of 60 percent of the average number of units qualifying for the respective housing goal during the immediately preceding five years. These loans represent a small portion of the GSEs' overall mortgage purchases although these units comprise a large percentage of the low-income housing stock. Use of bonus points in this category could provide incentives for the GSEs to increase their purchases in underserved areas.

The 60 percent threshold, if it were in effect for 1999 GSE mortgage purchases, would be set at the following levels:

	Fannie Mae (No. of units)	Freddie Mac (No. of units)
Low- and Moderate-Income Housing Goal ..	26,294	16,971
Geographically Targeted Goal	25,193	14,889
Special Affordable Housing Goal	12,720	8,564

The Department estimates that, if bonus points for small rental properties had been in effect during 1996–1998, Freddie Mac's goal percentages would have increased by 0.89 percentage point on the Low-and Moderate-Income Housing Goal, 0.67 percentage point on the Geographically Targeted Goal, and 0.47 percentage point on the Special Affordable Housing Goal, based on average purchase volumes over this three-year period. Fannie Mae's goal percentages would have increased by 0.91 percentage point on the Low and Moderate Income Housing Goal, 0.76 percentage point on the Geographically Targeted Goal, and 0.43 percentage point on the Special Affordable Housing Goal.

The purpose of bonus points is to encourage the GSEs to establish a larger and more consistent presence for the GSEs in targeted segments of the mortgage market. During the period that the goals under this proposal are effective, the Department will carefully monitor the effects of the bonus points approach in the housing categories in which they are being applied, to determine whether they are effective in incorporating the financing of properties targeted by the bonus points into the GSEs' mainstream activities. The Department does not plan to award bonus points to the GSEs after December 31, 2003, unless the Department specifically chooses to extend their availability in accordance with provisions of the rule.

b. *Subgoals.* Alternatively, HUD is considering using subgoals to encourage the GSEs to undertake activities to address the unmet credit needs of groups or areas and/or to support public policy initiatives that are consistent with the GSEs' public purposes. HUD may establish subgoals under any of the three housing goals although HUD may only enforce subgoals under the Special Affordable Housing Goal.[65] While FHEFSSA prohibits the enforcement of subgoals under the Low- and Moderate-Income Housing Goal or the Geographically Targeted Goal, the use of subgoals, whether or not they are enforceable, could encourage the GSEs to address unmet credit needs by directing the GSEs' and the public's attention on particular needs. For example, the special affordable housing multifamily subgoal has focused the GSEs' attention on special affordable multifamily activities.

In the 1995 rulemaking, HUD chose not to establish subgoals under either the Low- and Moderate-Income Housing Goal or the Geographically Targeted Goal, despite a number of comments urging the use of such tools. At that time, HUD expressed concern that the establishment of subgoals might be construed as micromanagement of the GSEs' business decisions at that relatively early post-FHEFSSA stage.[66] However, since issuance of the 1996 to 1999 housing goals, HUD has conducted extensive analyses of the GSEs' operations under the housing goals, as well as the size and components of the primary mortgage market. Based on this analysis, HUD can better identify areas of unmet credit needs. Inasmuch as Congress, in FHEFSSA, explicitly authorized HUD to create subgoals—although they would be largely

[65] Section 1332(a) of the FHEFSSA grants HUD authority to ''establish separate specific subgoals within the [Low- and Moderate-Income Housing] goal. * * *'' Section 1334(a) contains a similar provision for the Geographically Targeted Goal. Section 1333 allows HUD to establish subgoals under the Special Affordable Housing Goal that are enforceable.

[66] *See id.*

unenforceable—and in light of increased experience under the goals, HUD requests comments on the extent to which HUD should utilize subgoals.

c. *Areas Under Consideration for Bonus Points and/or Subgoals.* In addition to those areas described above, for which HUD proposes to award bonus points, HUD has identified several areas of unmet credit needs that could be addressed through the use of bonus points or subgoals, as appropriate. These areas are listed below, along with the possible rationale for taking such approach(es).

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Area of Concern	Rationale
Manufactured housing	Manufactured housing provides some of the most affordable owner-occupied housing for families targeted by HUD's housing goals. In fact, three-quarters of
Single family loans to categories of minorities which data indicates are underserved	Data indicates that certain categories of borrowers have lower home ownership rates than "served" borrowers and they
Single family and multifamily rehabilitation loans	Single family: More funds are needed for purchasing (or refinancing) homes in need of repairs. Multifamily: GSEs apply more stringent underwriting requirements for properties that are
Single family and multifamily loans in tribal areas	While Fannie Mae has participated in HUD's Section 184 program, which promotes affordable housing opportunities for Native Americans,
Single family and multifamily loans in Empowerment Zones/ Enterprise Communities (EZ/EC)	Potential borrowers in these distressed communities have a greater demand for products that allow flexible underwriting including consideration of non-traditional credit information.
Low-income borrowers and tenants in underserved portions of non-metropolitan areas	Studies show that certain parts of rural areas continue to be underserved by the secondary market.
Expiring Section 8 contracts.	The Mark-to-Market legislation provided that the GSEs should receive credit for actions that assist in maintaining the affordability of assisted units in eligible multifamily housing

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In addition to the specific rule changes proposed above, the Department invites comment on the following:

(1) Should HUD use either bonus points or subgoals to target mortgage purchases for one or more of the areas of concern identified above?

(2) Would one or more of these areas benefit more from bonus points or the establishment of subgoals and why? If bonus points are suggested, what amount of bonus points should be assigned, and why?

(3) Are there other areas not identified where bonus points and/or subgoals should be considered?

6. *Calculating Performance Under the Housing Goals.* In the current regulation, HUD set forth general requirements for counting the GSEs' performance under the housing goals in § 81.15, special counting requirements in § 81.16 (including specific exclusions from eligibility in § 81.16(b)), additional special requirements pertaining to counting under the Special Affordable Housing Goal in § 81.14, and rules for classifying families and units into income ranges in §§ 81.17–81.19. HUD's experience since the 1995 issuance of the current regulations indicates that several of these counting rules require clarification to ensure that they are understood and applied in a consistent manner and that the GSEs are achieving FHEFSSA's objectives. HUD invites comment on these clarifications and revisions described below.

a. *Temporary Adjustment Factor for Freddie Mac.* In response to widespread default losses, Freddie Mac ceased purchasing multifamily mortgages for a period of time in the early 1990s. However, Freddie Mac significantly expanded its presence in the multifamily mortgage market in the period since HUD's Interim Housing Goals took effect at the beginning of 1993, with purchases totaling $191 million that year. Freddie Mac's purchases reached $6.6 billion in 1998 and $3.4 billion in the first six months of 1999.

Despite this progress, Freddie Mac's presence in the multifamily market lags far behind that in single-family. Multifamily mortgages held in portfolio or guaranteed by Freddie Mac represented only 3 percent of the outstanding stock of such mortgages as of the end of the third quarter of 1998, compared with 16 percent of single-family mortgages. Corresponding figures for Fannie Mae are 11 percent in multifamily and 21 percent in single-family.[67]

Because of the importance of multifamily acquisitions to the GSE housing goals, the limited scope of Freddie Mac's multifamily acquisition volume has impaired its performance on HUD's housing goals. For example, while multifamily units accounted for only 8 percent of Freddie Mac's overall 1997 business, they accounted for 31 percent of units qualifying toward the Special Affordable Housing Goal, and 19 percent of the units qualifying for the Low- and Moderate-Income Goal. Thus, improved performance by Freddie Mac on the housing goals will require strengthening its efforts in the multifamily mortgage market.

To overcome any lingering effects of Freddie Mac's decision to leave the multifamily market in the early 1990s, it is reasonable for the Department to provide an incentive for Freddie Mac to further expand its scope of multifamily operations. The Department is proposing a ''Temporary Adjustment Factor'' for Freddie Mac's multifamily mortgage purchases for purposes of calculating performance on the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal. In determining Freddie Mac's performance for each of these two goals, each unit in a property with more than 50 units meeting one or both of these two housing goals would be counted as 1.2 units in calculating the numerator of the respective housing goal percentage. The Temporary Adjustment Factor would be limited to properties with more than 50 units because of separate provisions regarding multifamily properties with 5–50 units, discussed separately in Section II,B,5,a,(1).

The Temporary Adjustment Factor would terminate December 31, 2003. The Adjustment Factor would not be applied to the Geographically Targeted Goal. The Adjustment Factor would not apply to Fannie Mae.

The Department estimates that, if the Temporary Adjustment Factor were in effect during 1996–1998, it would have raised Freddie Mac's performance on the Low- and Moderate-Income Housing Goal by 1.52 percentage points and the Special Affordable Housing Goal by 0.86 percentage points.

HUD specifically requests comments on whether the proposed temporary adjustment factor for Freddie Mac is set at an appropriate level, and if such an adjustment factor should be phased out prior to 2003 or apply for the entire four year cycle.

b. *Data on Unit Affordability.* As indicated in § 81.15(a), each GSE must obtain all required information to determine whether units financed by the GSE purchased mortgages that qualify for one or more of the goals. If any of the information is missing, the GSEs must exclude the mortgage purchase from the numerator as not qualifying but they must include the mortgage in the denominator as a mortgage purchase in calculating performance under a housing goal.[68] The Senate Report on FHEFSSA noted the presence of an ''information vacuum'' with regard to the GSEs' mortgage purchases, indicating Congress' intention that the Department require accurate and comprehensive data regarding the GSEs' mortgage purchases for purpose of measuring compliance with the housing goals.[69] Therefore, the Department is committed to maintaining a complete and fully reliable loan level data base of the GSEs' mortgage purchases.

The GSEs have indicated that, for certain single family and multifamily mortgage purchases, it is difficult, and therefore costly, to obtain the necessary data on incomes and rents for all units associated with their mortgage purchases, especially for seasoned loan transactions and some negotiated transactions. The GSEs have requested the authority to use estimation techniques to approximate the unit rents in multifamily properties where current rental information is unavailable and to exclude units from the goal calculations where it is impossible to obtain full data or estimate values.

While providing the GSEs relief from the requirement to obtain rental data would remove an incentive to collect such information, the Department recognizes that the lack of such data in the mortgage market poses potentially insurmountable difficulties for the GSEs for a portion of their mortgage purchases. The Department, therefore, proposes the following measures for treatment of cases where a GSE does not obtain full data. The Department seeks comments on these proposals and welcomes suggestions for alternative ways of addressing the issue.

(1) *Multifamily Rental Units.* For purposes of counting rental units

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[67] Source: *Federal Reserve Bulletin,* March 1999, p. A35. HUD estimates that, in 1997, Freddie Mac acquired mortgages representing approximately 7 percent of the conventional multifamily market, compared with 17 percent of the conventional, conforming single family market. Corresponding estimates for Fannie Mae are 21 percent of multifamily and 31 percent of single family.

[68] Purchases of mortgages originated prior to 1993 with missing data may be excluded from the denominator.

[69] See Sen. Rep. at 33.

toward achievement of the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal, the current regulation requires that mortgage purchases financing eligible units be evaluated based on either the income of the tenant, or where this information is unknown, on the actual or average rent relative to area median income, as of the time the mortgage was acquired.[70] The GSEs generally use rental data in calculating goal achievement.

For units in multifamily properties (five or more units), the Department proposes to allow the use by a GSE of estimated rents based on market rental data. The Department will review and approve the GSEs' data sources and methodologies for estimating rents on multifamily units prior to their use, to assure reliability. Rental data submitted to the Department based on an estimation shall be so identified by the GSE. HUD requests comments on whether it should establish a percentage ceiling for the GSEs' use of estimated data for multifamily mortgage purchases.

The Department further proposes to exclude units in multifamily properties from the denominator as well as the numerator in calculating performance under the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal when sufficient information is not available to determine whether the purchase of a mortgage originated after 1992 counts toward achievement of the goal, and when the application of estimated rents based on an approved market rental data source and methodology is not possible. HUD requests comments on whether it should establish a percentage ceiling for the exclusion of multifamily units with missing data from the denominator for goal calculation purposes when estimated rents are not available. Because a relatively large portion of multifamily units count toward the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal, an incentive for the GSEs to provide affordability data would remain in place even if such data were excluded from the denominator without limitation.

(2) *Single Family Rental Units.* For purposes of counting rental units in 1–4 unit single family properties toward achievement of the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal, the Department proposes to exclude the rental units in 1–4 unit properties from the denominator as well as the numerator in calculating performance under the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal when sufficient information is not available to determine whether the purchase of a mortgage originated after 1992 counts toward achievement of the Low- and Moderate Income Housing Goal or the Special Affordable Housing Goal. HUD requests comments on whether it should establish a percentage ceiling for the exclusion of single family rental units with missing data from the denominator for goal calculation purposes when estimated rents are not available. Because a relatively large proportion of rental units in 1–4 unit single family properties count toward the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal, an incentive for the GSEs to provide affordability data would remain in place even if such data were excluded from the denominator without limitation.

(3) *Single Family Owner-Occupied Units.* For purposes of counting single family owner-occupied units toward achievement of the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal, the current regulation requires that mortgage purchases financing eligible owner units be evaluated based on the income of the owner relative to area median income, as of the time the mortgage was originated.[71]

The Department proposes to allow a GSE to exclude certain single family owner-occupied units from the denominator as well as the numerator in calculating performance under the Low- and Moderate-Income Housing Goal when the GSE lacks sufficient information on borrower income to determine whether the purchase of a mortgage originated after 1992 counts toward achievement of the goal, provided the mortgaged property is located in a census tract with median income less than or equal to area median income according to the most recent census. Such exclusion from the denominator and numerator will be permitted up to a ceiling of one percent (1%) of the total number of single family, owner-occupied dwelling units eligible to be counted toward the respective housing goal in the current year. Mortgage purchases in excess of the ceiling will be included in the denominator and excluded from the numerator.

HUD's analysis of GSE loan-level data indicates that the share of single-family owner-occupied units qualifying for the Low- and Moderate Income Housing Goal and the Special Affordable Housing Goal is significantly higher in tracts with median income less than or equal to area median income (''low-mod tracts'') than in other tracts, and is in fact higher than the GSEs'' overall goals performance across all property types. Consequently, excluding such units from the numerator and denominator in cases where income data are missing is unlikely to result in measured goals performance exceeding actual goals performance.

c. *Seasoned Mortgage Loan Purchases ''Recycling'' Requirement.* Under section 1333(b)(1)(B) of FHEFSSA, special rules apply for counting purchases of portfolios of seasoned mortgages under the Special Affordable Housing Goal. Specifically, the statute requires that purchases of seasoned mortgage portfolios receive full credit toward the achievement of the Special Affordable Housing Goal if ''(i) the seller is engaged in a specific program to use the proceeds of such sales to originate additional loans that meet such goal; and (ii) such purchases or refinancings support additional lending for housing that otherwise qualifies under such goal to be considered for purposes of such goal.'' [72] HUD refers to this provision as the ''recycling requirement.''

Section 81.14(e)(4)(i) of HUD's regulations clarify the meaning of the phrase ''engaged in a specific program to use the proceeds of such sales to originate additional loans that meet'' the Special Affordable Housing Goal by providing that:

> [A] seller must currently operate on its own or actively participate in an ongoing program that will result in originating additional loans that meet the goal. Actively participating in such a program includes actively participating with a qualified housing group that operates a program resulting in the origination of loans that meet the requirements of the goal.

Section 81.14(e)(4)(ii) provides that the GSEs must verify and monitor that the seller is engaging in a specific program to use the proceeds of such sales to originate additional loans that meet the Special Affordable Housing Goal.

Based on a review of the GSEs' performance under the Special Affordable Housing Goal, the Department believes further guidance is needed with regard to the recycling requirements described above to ensure that mortgage purchases granted full credit under this provision satisfy the purposes of FHEFSSA and, at the same

[70] 24 CFR 81.15(e). Rental information may be presented for type-of-unit categories identified by number of bedrooms and average rent level.

[71] 24 CFR 81.15(d).

[72] 12 U.S.C. 4563(b)(1)(B).

time, to ensure that the rules are applied so as to avoid any unnecessary regulatory burden. The Department, therefore, proposes to amend its regulations to further explain the requirements for the GSEs to receive full credit under these provisions and to establish new, simpler rules when it is evident based on the characteristics of a mortgage seller, including the seller's legal responsibilities, that the recycling requirements are met. The new rules would provide that for a mortgage purchase to meet the recycling requirements:

(1) The seller must currently operate on its own or actively participate in an on-going, discernible, active, and verifiable program directly targeted at the origination of new mortgage loans that qualify under the Special Affordable Housing Goal.

(2) The seller's activities must evidence a current intention or plan to reinvest the proceeds of the sale into mortgages qualifying under the Special Affordable Housing Goal, with a current commitment of resources on the part of the seller to this purpose.

(3) The seller's actions must evidence willingness to buy qualifying loans when these loans become available in the market as part of active, on-going, sustainable efforts to ensure that additional loans that meet the goal are originated. Actively participating in such a program includes purchasing qualifying loans from a correspondent originator, including a lender or qualified housing group, that operates an on-going program resulting in the origination of loans that meet the requirements of the goal, has a history of delivering, and currently delivers, qualifying loans to the seller.

Under this proposed rule, as under the current requirements, the GSEs must ordinarily verify and monitor that sellers meet the foregoing requirements and develop any necessary mechanisms to ensure compliance with these requirements. However, HUD does not believe that the efforts of the GSEs are well spent on monitoring compliance when, because of the nature and responsibilities of particular sellers, it is clear that the seller meets the recycling requirements. For this reason, the rule proposes that an institution that is (1) regularly in the business of mortgage lending; (2) a BIF-insured or SAIF-insured depository institution; and (3) subject to, and has received at least a satisfactory performance evaluation rating for at least the two most recent consecutive examinations under, the Community Reinvestment Act,[73] (which requires affordable lending), would meet the recycling requirements. The nature of such an institution's business and regulatory responsibilities require it to engage in a program that satisfies the recycling provisions. This rule, therefore, proposes that HUD and the GSEs may presume that such institutions, classified by the appropriate ''Type of Seller Institution'' data element, meet the recycling requirements.

Moreover, in the interest of further reducing unnecessary regulatory burden, HUD believes that there are certain additional classes of institutions or organizations that should be recognized as meeting the recycling requirements. For example, classes of institutions whose primary businesses are financing affordable housing mortgages, including possibly State Housing Finance Agencies or Special Affordable Housing Loan Consortia. For such classes of institutions or organizations, HUD is proposing that the GSEs may presume that they meet the recycling requirements. Classes of institutions or organizations must be approved by the Department and be appropriately identified in the GSEs' data submissions. Commenters are invited to provide their views on how to identify and define such classes of organizations or institutions.

In addition to specific changes proposed, commenters are invited to share their views as to whether any additional exemptions or changes to this provision should be established under the recycling provisions that would further its purpose. Comments are also specifically invited on (1) what, if any, provisions should be included in the proposed rule to address the various affiliate structures of depository institutions; and (2) the treatment under the recycling provisions of structured transactions where the mortgage loans included in the transaction were originated by a depository institution or mortgage banker engaged in mortgage lending on special affordable housing but acquired, packaged and re-sold by a third party, *e.g.,* an investment banking firm, that is not in the business of affordable housing lending.

An additional matter concerns the appropriate interpretation of § 81.16(c)(6) for counting seasoned mortgages. During the last four years, both GSEs have asserted that HUD's regulations permit the exclusion of purchases of seasoned mortgages from the denominator as well as from the numerator when the recycling requirements have not been met or when the status of loans with respect to this provision is unknown.

The GSEs believe that the regulation should be interpreted to mean that purchases of seasoned loans should not count in the denominator in calculating Special Affordable Housing Goal performance if the recycling requirements of section 1333(b)(1)(B) are not satisfied. The GSEs maintain that this provision defines whether such loans are ''mortgage purchases'' and thus, whether they are to be included in the denominator. As a result of this interpretation, Fannie Mae chooses not to undertake the verification and monitoring required to track compliance with the recycling provision and excludes the purchases from the denominator based on its lack of information. Freddie Mac chooses a similar treatment for those seasoned loans it does not count toward its Special Affordable Housing Goal performance.

In calculating its 1996 and 1997 performance under the Special Affordable Housing Goal, Fannie Mae excluded all seasoned loan purchases from both the numerator and the denominator for purposes of reporting its goals performance to HUD. The effect of this action was to reduce the denominator by 212,290 units in 1996 and 197,074 units in 1997, with the result that Fannie Mae considered its goal figures to be two percentage points higher than HUD's determination in 1996 and 2.15 percentage points higher in 1997. Freddie Mac counted most of its seasoned loan purchases towards the Special Affordable Housing Goal and, thus, there was only a marginal impact on its goal performance.

The Department has consistently maintained that the GSEs are required to count all mortgage purchases in the denominator. HUD's rules only permit the GSEs to exclude mortgages from the denominator under explicit circumstances. See §§ 81.15(a) and 81.16(b). As we have stated, the legislative history of FHEFSSA emphasizes the importance of accurate and comprehensive data.[74] On the other hand, experience indicates that incentives for the GSEs to gather accurate and comprehensive data may encourage the GSEs, in some instances, to avoid certain purchases altogether in order to keep such purchases out of their denominator, notwithstanding that such purchases may meet the other goals. Accordingly, while HUD has in the past disagreed with the GSEs' interpretation of its current rules, the Department is now proposing to consider the possibility of limited exceptions to the general rule where it

[73] 12 U.S.C. 2901 *et seq.*

[74] See Sen. Rep. at 33.

would be beneficial for the GSEs to purchase certain mortgages that simply will not meet recycling requirements, without having their goals performance effectively reduced by including the purchases in the denominator. An example would be a GSE's purchase of low- or moderate-income loans from a mortgage seller that enters and then leaves the affordable lending business. Such an entity may not meet the recycling requirements as a statutory matter because the seller would no longer be ''engaged in a specific program to use the proceeds of such sales to originate additional loans that meet the goal.'' [75] However, a GSE's willingness to purchase such mortgages may cause other originators to embark on affordable lending secure that the GSE will provide a secondary market for these loans.

To encourage affordable lending, this rule proposes to permit the Department in certain cases or classes of cases to allow the GSEs to exclude mortgages from the numerator and the denominator under the Special Affordable Housing Goal when the Department determines that such treatment serves to encourage the GSEs' mortgage purchases to further the purposes of the goal. To implement this change, HUD proposes to revise the language in § 81.16(c)(6) so that the Department may permit the exclusion of cases or classes of cases of purchases of seasoned mortgage loans from the numerator and the denominator in a GSE's calculations of performance under the Special Affordable Housing Goal when the Department determines such purchases further the purposes of the goal. The rule proposes that the GSE may request such treatment in writing and that the Department will respond to such request following the Department's determination. Commenters are specifically asked for their views regarding whether the Department should adopt this exclusion and, if so, what, if any, limits should be placed on it. To implement this change, HUD proposes to revise the language in § 81.16(c)(6) so that the Department may permit the exclusion of cases or classes of cases of purchases of seasoned loans from the numerator and the denominator in a GSE's calculations of performance under the Special Affordable Housing Goal when the Department determines such purchases further the purposes of the goal. The rule proposes that the GSE may request such treatment in writing and the Department will respond to such request following the Department's determination. Commenters are specifically asked for their views regarding whether the Department should adopt this exclusion and, if so, what, if any, limits should be placed on it.

d. *Counting Federally Insured Mortgages Including HECMs, Mortgages on Housing in Tribal Areas and Mortgages Guaranteed by the Rural Housing Service Under the Housing Goals.* Under HUD's current rules, non-conventional mortgages—mortgages that are guaranteed, insured or otherwise obligations of the United States—do not generally count under the three housing goals. (§ 81.16(b)(3)) Certain of these mortgages—including under the Home Equity Conversion Mortgage (HECM) Program, 12 U.S.C. 1715z–20, and the Farmers Home Administration's (now the Rural Housing Service's [RHS's]) Housing Loan Program—do, however, count under the Special Affordable Housing Goal. FHEFSSA specifically provides that mortgages that cannot be readily securitized through GNMA or another Federal agency and where a GSE's participation substantially enhances the affordability by statute receive full credit under the Special Affordable Housing Goal. On this basis, these two categories of mortgages count under that goal if they are for very low-income families or low-income families in low-income areas.

HECMs provide an important source of funds for senior citizens, especially those with lower incomes, who have paid off most or all of the mortgages on their homes and who wish to draw on the equity in their home to pay unanticipated expenses or to maintain a higher standard of living than they could support from their current income alone. Under HUD's HECM program they can do this without selling or risking the loss of their home. Fannie Mae has played a major role in the secondary market for HECMs, purchasing 5800 such loans in 1997 and 6700 such loans in 1998. Freddie Mac has not been involved in this program to date; inclusion of these loans for possible credit under all three of the housing goals will provide an incentive for them to play a role in the HECM market.

RHS loans are especially important to cash-strapped families in rural areas, since loan-to-value ratios can be as high as 100 percent. And the RHS's new Section 502 Direct Loan program is targeted to low-income and especially low-income families. Both GSEs have been involved in this market, with Fannie Mae purchasing 1600 such loans in 1997 and 2100 such loans in 1998, and Freddie Mac sharply stepping up its presence from 1400 such loans in 1997 to 3300 such loans in 1998. The GSEs also assist the RHS in outreach through the development of promotional and advertising materials.

One other area the Department is considering counting for goal credit are loans made to Native Americans under FHA's Section 248 program and HUD's Section 184 program. The paucity of home mortgage lending on American Indian reservations and trust lands has been well documented. Secretary Cuomo, in his remarks accompanying President Clinton to the Pine Ridge Indian Reservation in South Dakota, recently commented that ''The descendants of the first Americans shouldn't be locked out of the American Dream of homeownership.'' Allowing goal credit for FHA's Section 248 loans and HUD's Section 184 loans on reservations and trust lands will provide some support for these programs, though much greater efforts will be needed to make this dream of homeownership a reality.

Nonetheless, based upon its review of data on the GSEs mortgage purchases, HUD has concluded that HECMs, RHS mortgages and loans made to Native Americans under FHA's Section 248 program and HUD's Section 184 program comprise very small shares of the GSEs' business. At the same time, the properties secured by these mortgages present substantial and growing financing needs. Accordingly, while HUD maintains that non-conventional mortgages should be excluded under the goals where financing needs are already met by government programs, the Department also believes that non-conventional loans may count where financing needs are not well served. In such cases the goals will serve to direct the GSEs toward these needs. Accordingly, HUD proposes to amend its rules at § 81.16(b)(3) to except mortgages under the HECM program, mortgages guaranteed by RHS, and loans made under FHA's Section 248 program and HUD's Section 184 program on properties in tribal lands from the general exclusion under the rules for non-conventional loans. In addition, the rule allows the Department to count mortgage purchases under other non-conventional mortgage program(s) to count under the goals where the Department determines, in writing, that the financing needs addressed by such program are not well served and that mortgage purchases under such program should count. The proposed rule provides that where non-conventional mortgage purchases will now count toward the goal, they no longer will be

[75] 12 U.S.C. 4563(b)(1)(B).

excluded from the denominator of the GSEs' mortgage purchases as are other non-conventional loans.

e. *Counting Title I Loans.* During the transition period, from 1993 to 1995, HUD explicitly provided that home improvement and manufactured home loans for which lenders are insured under HUD's Title I program received half credit toward all three housing goals for which they qualified.[76] Following the transition period, HUD's 1995 final rule provided that, in accordance with section 1333(b)(1)(A) FHEFSSA, GSE purchases of non-conventional mortgages do not count toward the housing goals.[77] The exception to the rule is that Federally-related mortgages may receive full credit toward the Special Affordable Housing Goal if the mortgages would otherwise qualify for the goal, the Government National Mortgage Association (Ginnie Mae) cannot readily securitize them, and participation by the GSE substantially enhances their affordability.[78]

In a pilot program initiated between July 1996 and July 1997, Ginnie Mae was not successful in securitizing Title I loans. Moreover, while HUD has not analyzed whether GSE participation in these loans enhances their affordability, the pricing efficiencies that result from the securitization of mortgages suggest that an affordability analysis would be favorable.

Under the circumstances, HUD is proposing to amend § 81.14 to explicitly allow the GSEs to receive half credit for Title I loans under the Special Affordable Housing Goal. Units financed with Title I loans would be included at 100 percent (each unit counts as such) in the Special Affordable Housing Goal denominator, and included at 50 percent (each unit counts as such) in the Special Affordable Housing Goal numerator when they otherwise qualify for that goal. However, units financed with Title I loans would be excluded from the numerator and denominator in both the Low- and Moderate-Income Housing Goal and the Geographically Targeted Goal.[79]

f. *Defining the Denominator.* Section 81.15(a) of the 1995 final rule defines the denominator as ''the number of dwelling units that could count toward achievement of the goal under appropriate circumstances.'' HUD proposes to clarify this provision further by adding language to § 81.15 that specifically provides that the denominator shall not include GSE transactions or activities that are not mortgages or that are mortgage purchases or transactions which are specifically excluded as ineligible under § 81.16(b) of the regulations.

g. *Balloon Mortgages.* Single family mortgage refinances that result from the conversion of balloon notes to fully amortizing notes shall not count as mortgage purchases where the GSE already owns or has an interest in the balloon note at the time the conversion occurs and the GSE owns or has an interest in the fully amortizing note. Such conversions shall not be treated as a refinancing and shall not be counted in the numerator or denominator in calculating goal performance. Refinancings of balloon mortgages not owned by the GSE will be included in the denominator and numerator as appropriate. To implement this change to the special counting requirements, HUD proposes to revise the definition of ''Refinancing'' in § 81.2 to specifically exclude the conversion of balloon mortgages on single family properties and to add this provision to the special counting requirements in § 81.16.

h. *Expiring Assistance Contracts.* Section 517(c) of the Multifamily Assisted Housing Reform and Affordability Act of 1997[80] (the 1997 Act) provides that actions taken to assist in maintaining the affordability of assisted units in eligible multifamily housing projects with expiring Section 8 contracts ''shall constitute part of the contribution of each [GSE] in meeting its affordable housing goals * * *, as determined by the Secretary.'' The Department is proposing to add a provision to § 81.16 that provides partial or full credit for such actions. ''Actions'' under the 1997 Act relevant to the GSEs would include the restructuring or refinancing of mortgages, and credit enhancements or risk-sharing arrangements to modified or refinanced mortgages. Comments are invited on how and to what extent the GSEs should receive credit for such actions.

i. Especially Low Income. In accordance with section 1333 of FHEFSSA, § 81.14(d)(1)(i) currently provides that dwelling units in a multifamily property will count toward the Special Affordable Housing Goal if 20 percent of the units are affordable to families whose incomes do not exceed 50 percent of the area median income. Sections 81.17 through 81.19 provide that the income requirements are to be adjusted based on family size, and provide such adjustments for moderate-income families (income not in excess of 100 percent of area median income), low-income families (income not in excess of 80 percent of area median income), and very low-income families (income not in excess of 60 percent of area median income); but there is no similar adjustment table provided for families whose incomes do not exceed 50 percent of area median income. While such adjustments could be extrapolated from the adjustment tables provided in §§ 81.17 through 81.19, in order to assist the public, this rule proposes to amend these sections to provide additional adjustment tables for such families. In the interests of consistency, this rule also proposes to designate such families as ''especially low-income families'' for purposes of the Department''s GSE regulations. Section 81.14 of the proposed rule is amended to make such a designation.

j. Provision for HUD to Review New Activities to Determine Appropriate Counting Under the Housing Goals. While the GSEs participate in transactions and activities that support community and housing development in general, FHEFSSA is clear that only ''mortgage purchases'' count toward performance on the housing goals.[81] HUD's regulations provide that HUD will determine whether a transaction or activity is a ''mortgage purchase'' and will therefore count toward one or more of the goals for which it qualifies. Section 81.16 of the current regulations provides that in determining whether a GSE will receive full credit toward one or more of the goals for a transaction or activity, the Department will consider whether the transaction or activity ''is substantially equivalent to a mortgage purchase and either creates a new market or adds liquidity to an existing market.''

As provided in § 81.16(b), HUD has determined that certain transactions do not meet those criteria and therefore will not count toward a GSE's performance toward the housing goals (*e.g.,* equity investments in housing development projects; commitments, options, or rights of first refusal to acquire mortgages; state and local government housing bonds; and non-conventional mortgages, except under certain circumstances); such purchases are not included in the numerator or the denominator. HUD has also provided guidelines in the regulations for the treatment of other types of transactions, such as credit enhancements, real estate mortgage investment conduits

[76] Fannie Mae continued to count half credit for Title 1 purchases during 1996 through 1998.

[77] Section 81.16(b)(3).

[78] Section 81.14(e)(2).

[79] 12 U.S.C. 4563(b)(1)(A)(ii).

[80] Title V of HUD's 1998 Appropriations Act, Pub. L. 105–65, approved October 27, 1997.

[81] See Sen. Rep. at 38.

(REMICs), risk-sharing arrangements, participations, cooperative housing and condominiums, seasoned mortgages, refinanced mortgages, and mortgage revenue bonds.

In meeting the goal levels proposed here the GSEs will need to continue to develop products and approaches to close the gap between their performance and that of the primary mortgage market. In doing so, however, HUD and the GSEs must be mindful of FHEFSSA's requirements. Since only mortgage purchases count under the goals, this rule proposes new requirements to ensure timely guidance to the GSEs regarding new approaches or new types of transactions. Under the proposed revisions, in order to eliminate confusion about whether a given transaction will receive credit under the housing goals, the GSEs may provide information about specific transactions to the Department for evaluation and a determination of whether the transaction will receive full, partial, or no credit. The Department may also continue to independently request information of the GSEs about certain types of mortgage transactions. The Department will review the transactions to ensure that the counting of such transactions under the housing goals is consistent with FHEFSSA and advise the GSEs of the Department's determination with regard to credit for purposes of counting such transactions under the housing goals. This proposed rule amends § 81.16 to further clarify this point.

k. *Credit Enhancements.* The GSEs utilize a large variety of credit enhancements, for both single family and multifamily mortgage purchases, to reduce the credit risk to which they might otherwise be exposed. For example, the GSEs generally require the use of mortgage insurance on single-family loans with loan-to-value ratios exceeding 80 percent. While more common in the multifamily mortgage market, seller-provided credit enhancements may also be required for GSE purchases of single family mortgage loans when mortgage insurance is not carried on individual mortgage loans. Other types of credit enhancements include:

(1) Credit enhancements in structured transactions where a GSE may acquire a pool of loans, mortgage-backed securities (MBS), or real estate mortgage investment conduits (REMICs), and then create separate senior and subordinated securities, structured so that the subordinated securities absorb credit losses. The senior securities are guaranteed by the GSE; the subordinated securities are not.

(2) Spread accounts, in which a GSE may create a special class of unguaranteed securities where pass-through payments will cease in the event of default of the underlying mortgage collateral. Proceeds from the sale of such securities provide a degree of protection against credit losses. Such transactions differ from structured transactions in that no senior securities are explicitly created. Freddie Mac's 1998 ''MODERNs'' transactions are an example.[82]

(3) Acquisition of senior tranches of REMIC securities. In these transactions, the GSEs acquire senior tranches of REMICs which are enhanced by the presence of subordinate tranches. These senior tranches typically receive an investment-grade rating from one of the major rating agencies. A difference between this type of transaction and the structured transactions described above is that when the GSEs purchase a senior tranche, the collateral is already credit-enhanced prior to purchase.

(4) Agency pool insurance. A GSE reduces its exposure if insurance is provided by a mortgage seller on a pool of single family mortgage loans which may also individually carry mortgage insurance.

In its recent report titled ''HUD's Implementation of Its Mission Oversight Needs to Be Strengthened,'' dated July 28, 1998, GAO reviewed the effectiveness of HUD's regulation of the GSEs. As part of that report, GAO commented on the Department's treatment of credit enhancements under the current rule. GAO noted that by allocating full credit toward the housing goals on multifamily mortgages with seller provided credit enhancements, through which the seller of mortgages retains some of the credit risk on mortgages, HUD may be providing a ''regulatory incentive'' for the GSEs to utilize such enhancements.[83] These credit enhancements typically take the form of recourse to the seller or loss-sharing agreements between the seller and the GSE purchasing the mortgage.

The GAO commented further that HUD's treatment of mortgage purchases involving credit enhancements under the housing goals appears inconsistent with HUD's treatment of mortgages acquired by the GSEs under a risk-sharing program with FHA. Under § 81.16(c)(3) of the regulation, the GSEs receive housing goal credit for mortgage purchases under a risk-sharing arrangement only where the GSEs bear at least 50 percent of the credit risk. GAO noted that no similar requirement pertains to mortgages for which sellers provide credit enhancements, even, hypothetically, where a seller would bear 100 percent of the credit risk.

HUD responded that GSE credit enhancement transactions provide liquidity. Moreover, seller provided credit enhancements differ from the FHA risk-sharing program in that seller provided credit enhancements include an element of counterparty risk; in the sense that, in the event of default, some sellers lack the financial resources to fulfill their commitment to repurchase a loan or otherwise share in default losses.

In considering the treatment of credit enhancements, HUD invites comments on the following questions:

(i) Given the wide range of institutional arrangements pertaining to credit enhancements and the interrelationships between credit enhancements and other considerations such as loan-to-value ratio and guarantee fee, how might the credit risk to which the GSEs are exposed be measured under various types of credit enhancement scenarios?

(ii) Assuming credit risk can be adequately measured, should HUD give partial credit under the housing goals when credit enhancements result in a substantial portion of the credit risk of the transaction being borne by the seller or a third party? For example, if the GSE bears less than 50 percent of the credit risk of a transaction should the GSE receive no credit toward housing goal performance? If the GSEs assume between 50 percent and 75 percent of the credit risk of a transaction, should the GSE receive 50 percent credit for housing goal purposes?

(iii) What would be the advantages and disadvantages of linking the amount of goals credit on a GSE mortgage purchase to the degree of associated credit risk? What are the possible effects on low-and moderate-income families and on underserved areas of the GSEs' use of various credit enhancements and how might they be affected if goals credit were linked to the degree of associated credit risk? Would there be potential effects on liquidity or other mortgage market factors?

(iv) Assuming credit risk can be adequately measured, should HUD establish a minimum percentage in the range of 0 to 100 percent for the amount of credit risk borne by the GSEs on their

[82] ''MODERN'' is an acronym for Mortgage Default Recourse Notes. See ''Freddie Mac Trying Hand at One of Fastest Growing Practices in Mortgage Business: Captive Reinsurance,'' *Inside Mortgage Finance*, June 26, 1998, pp. 3; ''New Details on Freddie Mac's Novel MODERNS Transactions Emerge: 27% Coverage on All Defaults,'' *Inside MBS & ABS*, June 19, 1998.

[83] HUD's Implementation of Its Mission Oversight Needs to Be Strengthened, page 29 (GAO/GGD–98–173, July 28, 1998).

mortgage purchases in order for such purchases to count toward the housing goals?

(v) If HUD establishes a minimum threshold for credit risk, should it be the same for multifamily and single family purchases, or should it be different for each? At what level should the threshold(s) be established? Should HUD establish the same threshold for all types of credit enhancements, or should this differ between types of credit enhancements? At what level should the threshold(s) be established?

(vi) Should HUD measure counterparty risk on seller-provided credit enhancements? If so, how?

(vii) Should HUD evaluate GSE performance in relation to the use of credit enhancements by calculating and comparing the risk-adjusted rate of return under the use of various credit enhancement alternatives?

1. *High Cost Mortgage Loans.* There is ample evidence that high cost mortgage lending and abusive lending practices increase defaults, have destabilizing effects on neighborhoods, and adversely affect homeownership. High cost mortgage loans characterized by high interest rates and front-end fees are often coupled with requirements for balloon payments, negative amortization, prepayment penalties, and lump sum credit life insurance. Loans with these features sometimes are characterized as ''predatory; while they may prove profitable to some originators, they quickly erode home equity for unwary borrowers. Evidence suggests that high cost loans are often the product of ''reverse redlining;'' these loans tend to target low-income communities and elderly, minority, and immigrant borrowers who have traditionally been denied access to mainstream sources of credit.

In 1994, Congress addressed many abuses in the primary market with the Home Ownership and Equity Protection Act (HOEPA), which provides special disclosures and protections for borrowers of certain high cost refinance mortgages. (15 U.S.C. 1639) To be subject to HOEPA's requirements, mortgage loans covered under the law must have: (1) An annual percentage rate at least 10 points higher than the yield on Treasury securities with comparable maturity to the transaction; or (2) total points and fees payable by the consumer in excess of the greater of either $451 (an amount established annually under the law by the Federal Reserve) or eight percent of the amount loaned. (15 U.S.C. 1602(aa)) Purchasers of these loans, including the GSEs, assume certain legal responsibilities under the Truth in Lending Act (''assignee liability'').

Given the concerns about the adverse effects of high cost loans and abusive lending practices on neighborhoods and homeownership, the Department invites comments on whether this rule should disallow goals credit for high cost mortgage loans. The Department also seeks comments on the following: (1) If goals credit is restricted for such loans should the HOEPA definition be used, or should an alternative definition be established for purposes of this rule? (2) What are the potential benefits, if any, associated with the GSEs' presence in various higher cost mortgage markets including mortgages with annual percentage rates between those of the prime market and the market for high cost mortgage loans (for example, standardization of underwriting guidelines and reductions in interest rates)? (3) What are the potential dangers, if any associated with the GSEs' presence in various higher cost mortgage markets?

The presence of the GSEs in the higher cost mortgage markets would seem to warrant increased monitoring and additional reporting by the GSEs to HUD. The Department seeks comments on what additional data would be useful and whether certain of these elements should be included in the public use data base. Possible data elements that could be collected for Department monitoring purposes include loan level data on the annual percentage rate, debt-to-income ratio, points and fees, and prepayment penalties.

C. Subpart F—Access to Information

This subpart discusses proposed modifications to the Department's Final Order of October 1, 1996,[84] ''*Proprietary Data Submitted by the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac)*'' (the Final Order), under sections 1323 and 1326 of FHEFSSA. In the Final Order, HUD determined that certain mortgage data that HUD requires the GSEs to submit is proprietary and not to be included in the public use data base. Upon reviewing the previous order published as Appendix F of the 1995 Final Rule,[85] the Final Order finalized existing and identified additional GSE loan-level data elements for single family and multifamily mortgages that HUD determined were proprietary and, therefore, withheld from the public. The Final Order also identified certain data elements that HUD would recode, adjust, or categorize in ranges to protect against the release of proprietary information, as necessary. After careful review of the previous proprietary orders, the Department is proposing a number of changes to the classification of certain GSE single family and multifamily mortgage data elements. The list of data elements that HUD proposes to make available to the public is described in the following sections. Appendix E of this proposed rule also contains full matrices, similar to those found in proprietary orders, that incorporate the changes proposed in this rule. Release of these data elements to public access is consistent with Congress's intent that ''every effort should be made to provide public disclosure of the information required to be collected and/or reported to the regulator, consistent with the exemption for proprietary data.'' [86]

1. *Background on Public Use Data Base and Public Information.* Section 1323 of FHEFSSA requires that HUD make available to the public, data relating to the GSEs' mortgage purchases. In the legislative history of FHEFSSA, Congress indicated its intent that the GSE public use data base supplement the HMDA data.[87] The purpose of the data base is to assist mortgage lenders, planners, researchers, and housing industry groups, as well as HUD and other government agencies, in studying the flow of mortgage credit and capital into the nation's communities. At the same time, Section 1326 protects from public access and disclosure, proprietary data and information that the GSEs submit to the Department and requires HUD to protect such data or information by Order or regulation.

To comply with FHEFSSA, HUD established a public use data base to collect and make available to the public, loan-level data on the GSEs' single family and multifamily mortgage purchases. In Appendix F to the December 1, 1995 final rule, the Department specified the structure of the GSE public use data base and identified the data to be withheld from public use. The single family data was to be disclosed in three separate files—a Census Tract File (with geographic identifiers down to the census tract level), a National File A (with mortgage-level data on owner-occupied 1-unit properties), and a National File B (with unit-level data on all single-family properties). The national files do not

[84] Notice of the Order was published in the **Federal Register** on October 17, 1996 (61 FR 54322).

[85] 60 FR 62001.

[86] Senate Report 102–282, 102d Cong., 2d Sess. 40 (19992).

[87] *See, e.g.,* Rep. at 39.

have geographic indicators. The multifamily data was to be disclosed in two separate files—a Census Tract File and a National File consisting of two parts—one part containing mortgage loan level data and the other containing unit level data for all multifamily properties. For each file, the appendix identified data elements that were considered proprietary and those that were not proprietary and available to the public, and specified further that certain proprietary elements would be recoded or categorized into ranges to protect the proprietary information and to permit the release of non-proprietary information to the public. This multi-file structure was designed at that time to allow the greatest dissemination of loan-level data, without revealing information that would allow competitors to determine the GSEs' marketing and pricing strategies at the local level.

On October 17, 1996, the Final Order describing each data element submitted by the GSEs and the proprietary nature of each element was published in the **Federal Register**. The Final Order also recoded, adjusted, or categorized in ranges certain proprietary loan-level data elements to protect the proprietary nature of the GSE information. HUD released the recoded data elements and the data elements that were identified as non-proprietary information to the public.

In the fall of 1996, the Department released the first GSE public-use data base that contained non-proprietary information on every mortgage purchased by the GSEs from 1993 to 1995. Subsequently, HUD made the 1996 and 1997 databases available to the public.

2. *Changes Proposed in This Rule.* After consideration of the current structure of the public use data base, the Department is proposing several changes to its classifications of the GSEs' mortgage data. These changes are either technical in nature or would make available to the public the same data from the GSEs that is made available by primary lenders under HMDA. These changes, therefore, would not appear to release proprietary information and would, at the same time, affirm Congress's intent that the HMDA data base and the GSE data base complement each other.

a. GSE Single Family Mortgage Data

(1) The Department proposes to change the MSA Code (Field #4) from YES (proprietary) to YES but Recode and to make the recoded data publicly available in National File A and National File B. The Department proposes to recode this data as:

1=Metropolitan
2=Non-Metropolitan
9=Missing

This change will make possible analyses at the national level by researchers beyond HUD of a variety of issues relating to metropolitan and non-metropolitan mortgage lending and GSE activities and will facilitate comparison between the GSE and HMDA data bases. Individual MSAs will not be identified.

(2) The Department proposes to code the Borrower's Annual Income (Field #15) to ''99999999'' when missing. This change will permit the coding of larger borrower incomes.

(3) The Department proposes to change the Purpose of Loan (Field #22) from YES (proprietary) to NO (non-proprietary) and to make such data publicly available in the Census Tract File and National File A. The Department also proposes to add the following values:

4=Rehabilitation
9=Not Applicable/Not Available

These changes will make possible separate analyses by researchers beyond HUD of home purchase, refinance, second, and rehabilitation mortgages and will facilitate comparisons between the GSE and HMDA data bases.

(4) The Department proposes to change the Federal Guarantee (Field #27) from YES (proprietary) to NO (non-proprietary) and to make such data publicly available in the Census Tract File. These changes will make possible analyses by researchers beyond HUD of conventional and Federally guaranteed mortgages at the local level and will facilitate comparisons between the GSE and HMDA data bases.

(5) The Department proposes to change the Borrower Race/National Origin (Field #41) from YES (proprietary) to NO (non-proprietary) and to make such data publicly available in National File A and National File B. The Department also proposes not to combine Field #41 and Field #42 in National File A and National File B and to delete subgroup #7 indicating that Borrower and Co-Borrower are in different race/national origin categories. The Department also proposes to distinguish in the public use data base causes of missing data coded by the GSEs as ''7'' (information not provided in mail or telephone application), ''8'' (not applicable), and ''9'' (not available). These changes will make possible more precise analyses at the national level by researchers beyond HUD relating to household minority status and will facilitate comparisons between the GSE and HMDA data bases.

(6) The Department proposes to change Co-Borrower Race/National Origin (Field #42) from YES (proprietary) to NO (non-proprietary) and to make such data publicly available in National File A and National File B, as discussed above in paragraph (5) with respect to Field #42.

(7) The Department proposes to change the Occupancy Code (Field #47) from YES (proprietary) to (a) ''NO'' (non-proprietary) and make the data publicly available in National File A; and (b) ''YES but Recode'' and to make the recoded data publicly available in the Census Tract File. The Department proposes to recode this data as:

1=Owner-Occupied Property (1–4 units)
2=Investment Property (1–4 units)
9=Not Available

This change will make possible separate analyses by researchers beyond HUD for owner-occupied properties and rental properties and will facilitate comparisons between the GSE and HMDA data bases.

b. GSE Multifamily Mortgage Data

(1) The Department proposes to make Date of Mortgage Note (Field #19) available in the National File, subject to recoding as follows:

1=Originated Same Calendar Year as Acquired
2=Originated Prior to Calendar Year of Acquisition
9=Missing

The change will permit analysis of multifamily loans originated in prior years by researchers beyond HUD and will facilitate comparisons between the GSE and HMDA data bases.

(2) The Department proposes to change the Purpose of Loan (Field #21) to revise the definition of value ''9'' as follows: 9=Not Applicable/Not Available.

This is a clarifying change.

(3) The Department proposes to change Type of Seller Institution (Field #33) from YES (proprietary) to NO (non-proprietary) in the National File. This change, in connection with others being proposed, will facilitate comparisons between the GSE and HMDA data bases and will also facilitate analyses by researchers beyond HUD of affordability, property, size, and other key characteristics by type of seller at the national level.

3. *Comments Sought.* HUD's specification of the data elements to be included in the public use data base involves complex issues and requires sensitivity to both Congress's concern that there be complete and accurate data

on the GSEs' activities and that there be protection of legitimately proprietary information submitted by the GSEs to the Department. In addition to public comments on these issues along with specific examples of data where disclosure furthers the public interest, comments are requested on the specific changes proposed above. HUD is considering two other changes to the multifamily mortgage data base and invites comments on the nature of these changes—(a) making available information on the term of the mortgage at origination recoded to group the data into buckets (*e.g.,* less than seven years, seven years to less than ten years, ten years to less than 20 years, and more than 20 years); and (b) making available information on the type of acquisition (*e.g.,* cash, swap, credit enhancement, bond/debt purchased, missing and other). Both of these changes would enhance the type of multifamily analyses that could be conducted using the public use data base. Comment is also sought about whether certain data elements that are classified as proprietary when submitted to the Department might no longer be so classified after several years, because they would be unlikely to provide proprietary information about the GSEs' current business activities.

Finally, the Department requests comments on what additional loan level information regarding the GSEs' mortgage purchases—on either a census tract or national level—would be useful to release to expand the public's understanding of the role the GSEs play in the mortgage market. The Department must protect the GSEs' proprietary interests with regard to the loan level data. However, when initially establishing the loan level data base, HUD took a conservative approach in making determinations about the proprietary nature of the loan level data elements. With the benefit of several years of experience with the public use data base, HUD believes it is appropriate to review the initial determinations with regard to the proprietary nature of individual loan level elements and welcomes public comment on what additional data should be made available, why it is needed and how the GSEs might be impacted through the release of this information. Possible examples of data that might be of interest to the public is the availability of data on loan-to-value ratios, special loan program characteristics, and how individual loans are scored for housing goal purposes at the census tract level.

III. Specific Areas for Public Comment

Comment is invited on all aspects of the proposed regulation. In addition, the Department requests comments on several specific issues. These questions are discussed in context in Section II of the preamble and are repeated below for the convenience of commenters:

This proposed rule solicits comments on specific changes to definitions applicable to the housing goal levels, establishment of new housing goals, new requirements for counting mortgage purchases under the goals, and an expansion of loan level data available to the public on the GSEs' mortgage loan purchases.

A. Definitions

Comments are requested to the proposed definitional changes of the terms ''Median Income,'' ''Metropolitan Areas,'' ''Refinancing'' and ''Underserved Areas'' in § 81.2.

B. Housing Goal Levels

Comments are requested on the proposed level of the housing goals described below and on whether the level of the proposed housing goals is appropriate given the statutory factors HUD must consider in setting the goals, and in light of the market estimates of the GSEs' shares of the affordable housing market.

1. *Low- and Moderate-Income Housing Goal.* The rule proposes to amend § 81.2 to change the level of the annual housing goal for mortgage purchases qualifying under the Low- and Moderate-Income Housing Goal to be 48 percent of eligible units financed in calendar year 2000, and 50 percent of eligible units financed in each of calendar years 2001, 2002 and 2003.

2. *Central Cities, Rural Areas, and Other Underserved Areas Housing Goal (Geographically Targeted Goal).* The rule proposes to amend § 81.13 to change the level of the annual housing goal for mortgage purchases qualifying under the Geographically Targeted Goal to be 29 percent of eligible units financed in calendar year 2000, and 31 percent of eligible units financed in each of calendar years 2001, 2002 and 2003.

3. *Special Affordable Housing Goal.* The rule proposes to amend § 81.14 to change the level of the annual housing goal for mortgage purchases qualifying under the Special Affordable Housing Goal to be 18 percent of eligible units financed in calendar year 2000, and 20 percent of eligible units financed in each of calendar years 2001, 2002 and 2003.

4. *Special Affordable Housing Multifamily Subgoal.* For the calendar years 2000 through 2003, the rule proposes to amend § 81.14 to change the level of the annual housing subgoal for mortgage purchases qualifying under the Special Affordable Housing Multifamily Subgoal to be 0.9 percent of the dollar volume of combined (single family and multifamily) 1998 mortgage purchases in calendar year 2000, and 1.0 percent of the dollar volume of combined (single family and multifamily) 1998 mortgage purchases in each of calendar years 2001, 2002 and 2003.

C. Possible Changes to Underserved Areas in Geographically Targeted Goal

The Department is considering several possible changes to what is considered an underserved area for purposes of counting mortgage purchases under the Geographically Targeted Goal.

1. *Metropolitan Area.* HUD seeks comment on the proposed options for revising the definition of underserved metropolitan areas in an effort to more accurately target underserved areas with higher mortgage denial rates. Specifically, HUD is considering two possible changes to the definition. The first option being considered is to change the current tract income ratio to an ''enhanced'' tract income ratio and to require that for tracts to qualify they must (1) calculate the tract income ratio based on the ratio of tract median income to the greater of the national metropolitan median income or the MSA median income; and (2) have a tract income ratio at or below 80 percent. The second option being considered is to increase the requirement for a tract's minority population from the current 30 percent to 50 percent. The Department is also requesting comments on the extent to which these definitional changes are likely to increase the availability of credit to areas with high denial rates.

2. *Tribal Lands.* The Department seeks comment on the amended definition of underserved areas in § 81.2 that includes low-income and/or high minority American Indian Reservations and trust lands in the definition of underserved areas for both metropolitan and non-metropolitan areas.

3. *Rural Areas.* HUD also seeks public comment on alternative methodologies and sources of rural market data that HUD might use to define underserved non-metropolitan/rural areas. Specifically, HUD seeks comment on whether the Department should follow a tract-based approach in defining underserved rural areas, which would be consistent with the tract-based definition used in metropolitan areas. As technology and computer mapping

capabilities have evolved since 1995, it may be appropriate to revisit the issue of whether entire counties or census tracts within the counties should be used to define rural underserved areas.

D. Possible Changes to the Structure of the Special Affordable Housing Multifamily Subgoal

The Department seeks comment on whether the special affordable multifamily subgoal proposed that is based on a percentage of total dollar volume of mortgages purchased, or the possible alternative structures presented that base the subgoal on (a) the number of units financed, (b) a percent of current multifamily mortgage purchases, or (c) the number of mortgages acquired, are reasonable and desirable approaches to closing market gaps in the very low- and low-income rental market. HUD also solicits comment on the appropriate level for the subgoal as proposed, or under the various possible structures presented, and how the possible levels illustrated herein would likely impact multifamily acquisitions, especially for very low- and low-income multifamily units.

E. Bonus Points and Subgoals

Specifically, the Department invites comments on (a) whether, for the four year period ending December 31, 2003, § 81.16(c)(10) should be added to allow small multifamily properties (5–50 units) and all the units in owner-occupied 2–4 unit properties to receive double weight in the numerator for each of the three housing goals that otherwise qualify for the housing goals; and (b) how to count small multifamily properties for purposes of receiving bonus points that may be aggregated into larger financing packages. The Department also seeks comments on the utility of applying similar regulatory incentives (bonus points and/or subgoals) to other underserved segments of the market. In addition, HUD requests comments on the following questions that relate to bonus points and subgoals in general:

1. Whether HUD should use either bonus points or subgoals to target mortgage purchases for one or more of the areas of concern identified earlier?

2. Whether one or more of these areas would benefit more from bonus points or establishment of subgoals and why? If bonus points are suggested, the amount of bonus points which should be assigned and why?

3. Whether there are other areas not identified where bonus points and/or subgoals should be considered?

F. Calculating Performance Under the Housing Goals

The Department invites comments on clarifications and revisions to certain requirements for calculating performance under the housing goals.

1. *Temporary Adjustment Factor for Freddie Mac.* HUD requests comments on the proposal to provide Freddie Mac with an incentive to further expand the scope of its multifamily operations by providing them with a Temporary Adjustment Factor. The proposed rule calculates Freddie Mac's performance under the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal by counting each unit in a multifamily property with more than 50 units meeting the definition of one or both housing goals as 1.2 units (the Temporary Adjustment Factor) in the numerator in determining the respective housing goal percentage. HUD specifically requests comments on whether the proposed temporary adjustment factor for Freddie Mac is set at an appropriate level, and if such an adjustment factor should be phased out prior to 2003 or apply for the entire four year goal cycle.

2. *Data on Unit Affordability.* The Department seeks comments on the proposed revisions to § 81.15(d) and (e)(6) that identify the treatment for purposes of counting under the housing goals of those cases where a GSE does not obtain rental data on units, and welcomes suggestions for alternative ways of addressing the issue.

a. *Multifamily Rental Units.* For units in multifamily properties, the Department proposes to allow the use by a GSE of estimated rents based on market rental data. The Department will review and approve the GSEs' data sources and methodologies for estimating rents on multifamily units prior to their use, to assure reliability. Estimated rental data submitted to the Department shall be so identified by the GSE. HUD requests comments on whether it should establish a percentage ceiling for the GSEs' use of estimated data for multifamily mortgage purchases. The Department further proposes to allow a GSE to exclude units in multifamily properties from the denominator as well as the numerator in calculating performance under the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal when the GSE lacks sufficient information to determine whether the purchase of a mortgage originated after 1992 counts toward achievement of the goal, and when the application of estimated rents based on an approved market rental data source and methodology is not possible.

b. *Single Family Rental Units.* For purposes of counting rental units in 1–4 unit single family properties toward achievement of the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal, the Department proposes to allow a GSE to exclude the rental units in 1–4 unit single family properties from the denominator as well as the numerator in calculating performance under the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal when the GSE lacks rent sufficient information to determine whether the purchase of a mortgage originated after 1992 counts toward achievement of the Low- and Moderate Income Housing Goal or the Special Affordable Housing Goal.

c. Single Family Owner-Occupied Units. Comments are requested on the Department's proposal to allow a GSE to exclude certain single family owner-occupied units from the denominator as well as the numerator in calculating performance under the Low- and Moderate-Income Housing Goal when the GSE lacks sufficient information on borrower income to determine whether the purchase of a mortgage originated after 1992 counts toward achievement of the goal, provided the mortgaged property is located in a census tract with median income less than or equal to area median income according to the most recent census. Such exclusion from the denominator and numerator will be permitted up to a ceiling of one percent (1%) of the total number of single family, owner-occupied dwelling units eligible to be counted toward the respective housing goal in the current year. Mortgage purchases in excess of the ceiling will be included in the denominator and excluded from the numerator.

3. Seasoned Mortgage Loan Purchases. Comments are requested on specific changes that are proposed in § 81.14 that address how purchases of seasoned mortgage portfolios receive full credit under the Special Affordable Housing Goal. Changes to § 81.16 are proposed to clarify the treatment of seasoned mortgages in calculating goal performance. The suggested changes specifically provide direction and guidance to the GSEs for the purpose of determining whether a seller of special affordable seasoned mortgage portfolios is adequately engaged in a specific program to reinvest the proceeds of the loan sale into additional special affordable lending. In addition, commenters are invited to provide their views on how to identify and define

those classes of organizations or institutions who are primarily engaged in financing affordable housing mortgages, including possibly State Housing Finance Agencies or Special Affordable Housing Loan Consortia, or other types of businesses that further the purpose of the Special Affordable Housing Goal. In addition to specific proposed changes to the regulation, commenters are invited to share their views as to whether any additional exemptions or changes should be established under the recycling provisions that further its purpose. Comments are also specifically invited on (1) what, if any, provisions should be included in the proposed rule to address the various affiliate structures of depository institutions; and (2) the treatment under the recycling provisions of structured transactions where the mortgage loans acquired were originated by a depository institution or mortgage banker engaged in mortgage lending on special affordable housing but acquired and sold by a third party, *e.g.,* an investment banking firm that is not in the business of affordable housing lending.

4. *Certain Federally Insured or Guaranteed Mortgages.* Comments are requested on the proposed change to § 81.16(b)(3) to except mortgages under the HECM program, mortgages guaranteed by RHS and loans made under FHA's Section 248 program and HUD's Section 184 program on properties in tribal lands from the general exclusion under the rules for non-conventional mortgage loans, and to allow the Department to count non-conventional mortgage purchases under the goals where the Department determines, in writing, that the financing needs addressed by such program are not well served and that mortgage purchases under such program should count. In addition, the proposed rule provides that where non-conventional mortgage purchases will now count toward the housing goals, they no longer will be excluded from the denominator of the GSEs' mortgage purchases as are other non-conventional mortgage loans.

5. *Other Counting Changes.* Comments are welcome on the following specific changes to counting requirements contained in the proposed rule: (a) Allowing half-credit for purchases of HUD Title I loans under the Special Affordable Housing Goal (§ 81.14); (b) amending the calculation of ''Denominator'' to clarify that the denominator does not include GSE transactions or activities that are not mortgages or that are specifically excluded mortgage purchase transactions (§ 81.16); (c) excluding certain single family balloon mortgages from treatment as a refinancing at the time of conversion to a fully amortizing note (§§ 81.2 and 81.16); (d) providing partial or full credit for actions that assist in maintaining the affordability of multifamily properties with expiring assistance contracts including how and to what extent the GSEs should receive credit for such actions; and (e) adding the designation of ''especially low-income'' in relationship to the Special Affordable Housing Goal (§§ 81.14, 18.17, 81.18, and 81.19). In addition, while no specific change has been proposed, comments are requested on whether the final rule should disallow goals credit for high cost mortgage loans. The Department also seeks comments on the following: (i) If goals credit is restricted for such loans, should the HOEPA definition be used, or should an alternative definition be established for purposes of this rule? (ii) What are the potential benefits, if any, associated with the GSEs' presence in the various higher cost mortgage markets including mortgages with annual percentage rates between those of the prime market and the market for high cost mortgage loans (for example, standardization of underwriting guidelines and reductions in interest rates)? (iii) What are the potential dangers, if any, associated with the GSEs' presence in various higher cost mortgage markets? Finally, the Department requests comments on what additional reporting data would be useful for the purposes of monitoring the GSEs' activities in this area and on whether certain of these data elements should be included in the public use data base. Possible data elements that could be collected for Department monitoring purposes include loan level data on the annual percentage rate, debt-to-income ratio, points and fees, and prepayment penalties.

6. *Provision for HUD to Review New Activities to Determine Appropriate Counting Under the Housing Goals.* The Department is requesting comments on the proposal to add a provision (§ 81.16(d)) for HUD to review activities of the GSEs to ensure that the counting of transactions towards the housing goals is consistent with FHEFSSA and advise the GSEs of the Department's determination with regard to credit for purposes of counting such transactions under the housing goals.

7. *Credit Enhancements.* In relation to credit enhancements, HUD invites comments on the following questions:

a. Given the wide range of institutional arrangements pertaining to credit enhancements and the inter-relationships between credit enhancements and other considerations such as loan-to-value ratio and guarantee fee, how should the credit risk to which the GSEs are exposed be measured under various types of credit enhancement scenarios?

b. Assuming credit risk can be adequately measured, should HUD give partial credit under the housing goals when credit enhancements result in a substantial portion of the credit risk of the transaction being borne by the seller or a third party? For example, if the GSE bears less than 50 percent of the credit risk of a transaction should the GSE receive no credit toward housing goal performance? If the GSE assumes between 50 percent and 75 percent of the credit risk of a transaction, should the GSE receive 50 percent credit for housing goal purposes?

c. What would be the advantages and disadvantages of linking the amount of goals credit on a GSE mortgage purchase to the degree of associated credit risk? What are the possible effects on low- and moderate-income families and on underserved areas of the GSEs' use of various credit enhancements and how might they be affected if goals credit were linked to the degree of associated credit risk? Would there be potential effects on liquidity or other mortgage market factors?

d. Assuming credit risk can be adequately measured, should HUD establish a minimum percentage in the range of 0 to 100 percent for the amount of credit risk borne by the GSEs on their mortgage purchases in order for such purchases to count toward the housing goals?

e. If HUD establishes a minimum threshold for credit risk, should it be the same for multifamily and single family purchases, or should it be different for each? Should HUD establish the same threshold for all types of credit enhancements, or should this differ between types of credit enhancements? At what level should the threshold(s) be established?

f. Should HUD measure counterparty risk on seller-provided credit enhancements? If so, how?

g. Should HUD evaluate GSE performance in relation to the use of credit enhancements by calculating and comparing the risk-adjusted rate of return under the use of various credit enhancement alternatives?

G. Access to Information

HUD's specification of the data elements to be included in the public use data base involves complex issues and requires sensitivity to both Congress's concern that there be complete and accurate data on the GSEs' activities and that there be protection of legitimately proprietary information submitted by the GSEs to the Department. In addition to public comments on these issues along with specific examples of data where disclosure furthers the public interest, comments are requested on the specific changes proposed to the rule. HUD is considering two other changes to the multifamily mortgage data base and invites comments on the feasibility of these changes—(a) making available information on the term of the mortgage at origination recoded to group the data into buckets; and (b) making available information on the type of acquisition. Both of these changes would enhance the type of multifamily analyses that could be conducted using the public use data base. Comment is also sought about whether certain data elements that are classified as proprietary when submitted to the Department might no longer be so classified after several years, because they would be unlikely to provide proprietary information about the GSEs' current business activities. Finally, the Department requests comments on what additional loan level information regarding the GSEs' mortgage purchases—on either a census tract or national level—would be useful to release to expand the public's understanding of the role the GSEs play in the mortgage markets.

IV. Findings and Certifications

A. Executive Order 12866

The Office of Management and Budget (OMB) reviewed this proposed rule under Executive Order 12866, *Regulatory Planning and Review,* which the President issued on September 30, 1993. This rule was determined economically significant under E.O. 12866. Any changes made to this proposed rule subsequent to its submission to OMB are identified in the docket file, which is available for public inspection between 7:30 a.m. and 5:30 p.m. weekdays in the Office of the Rules Docket Clerk, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, S.W., Washington, DC. The initial Economic Analysis prepared for this rule is also available for public inspection in the Office of the Rules Docket Clerk.

B. Congressional Review of Major Final Rules

This rule is a ''major rule'' as defined in Chapter 8 of 5 U.S.C. The rule will be submitted for Congressional review in accordance with this chapter at the final rule stage.

C. Paperwork Reduction Act

HUD's collection of information on the GSEs' activities has been reviewed and authorized by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501–3520), as implemented by OMB in regulations at 5 CFR part 1320. The OMB control number is 2502–0514.

D. Environmental Impact

In accordance with 24 CFR 50.19(c)(1) of HUD's regulations, this proposed rule would not direct, provide for assistance or loan and mortgage insurance for, or otherwise govern or regulate real property acquisition, disposition, lease, rehabilitation, alteration, demolition, or new construction; nor would it establish, revise, or provide for standards for construction or construction materials, manufactured housing, or occupancy. Therefore, this proposed rule is categorically excluded from the requirements of the National Environmental Policy Act.

E. Regulatory Flexibility Act

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed this rule before publication and by approving it certifies that this rule would not have a significant economic impact on a substantial number of small entities. This proposed regulation is applicable only to the GSEs, which are not small entities for purposes of the Regulatory Flexibility Act, and, thus, does not have a significant economic impact on a substantial number of small entities.

F. Executive Order 13132, Federalism

Executive Order 13132 (''Federalism'') prohibits, to the extent practicable and permitted by law, an agency from promulgating a regulation that has federalism implications and either imposes substantial direct compliance costs on State and local governments and is not required by statute, or preempts State law, unless the relevant requirements of section 6 of the Executive Order are met. This final rule does not have federalism implications and does not impose substantial direct compliance costs on State and local governments or preempt State law within the meaning of the Executive Order.

G. Unfunded Mandates Reform Act

Title II of the Unfunded Mandates Reform Act of 1995 [88] (UMRA) establishes requirements for Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments, and the private sector. This proposed rule would not impose any Federal mandates on any State, local, or tribal governments, or on the private sector, within the meaning of the UMRA.

List of Subjects in 24 CFR Part 81

Accounting, Federal Reserve System, Mortgages, Reporting and recordkeeping requirements, Securities.

Accordingly, 24 CFR part 81 is proposed to be amended as follows:

PART 81—THE SECRETARY OF HUD'S REGULATION OF THE FEDERAL NATIONAL MORTGAGE ASSOCIATION (FANNIE MAE) AND THE FEDERAL HOME LOAN MORTGAGE CORPORATION (FREDDIE MAC)

1. The authority citation for 24 CFR part 81 continues to read as follows:

Authority: 12 U.S.C. 1451 *et seq.*, 1716–1723h, and 4501–4641; 42 U.S.C. 3535(d) and 3601–3619.

2. Section 81.2, is amended by revising the definitions of ''*Median Income*'' ''*Metropolitan Area*'', and ''*Underserved Area,*'' and by adding a new paragraph (7) to the definition of ''*Refinancing,*'' to read as follows:

§ 81.2 Definitions.

* * * * *

Median Income means, with respect to an area, the unadjusted median family income for the area and most recently determined and published by HUD. HUD will provide the GSEs, on an annual basis, with information specifying how HUD's published median family income estimates for metropolitan areas are to be applied for the purposes of determining median family income in such areas.

Metropolitan Area means a metropolitan statistical area (''MSA''), or primary metropolitan statistical area (''PMSA''), or a portion of such an area for which median family income estimates are published annually by HUD.

* * * * *

Refinancing means: * * *

* * * * *

(7) A conversion of a balloon mortgage note on a single family property to a fully amortizing mortgage note provided the GSE already owns or

[88] Pub. L. 104–4, approved March 22, 1995.

has an interest in the balloon note at the time of the conversion.

* * * * *

Underserved Area means:

(1) For purposes of the definitions of ''*Central City*'' and ''*Other Underserved Area*'', a census tract, a Federal or State American Indian reservation or tribal or individual trust land, or the balance of a census tract excluding the area within any Federal or State American Indian reservation or tribal or individual trust land, having:

(i) A median income at or below 120 percent of the median income of the metropolitan area and a minority population of 30 percent or greater; or

(ii) A median income at or below 90 percent of median income of the metropolitan area.

(2) For purposes of the definition of ''*Rural Area*'':

(i) In areas other than New England, a whole county, a Federal or State American Indian reservation or tribal or individual trust land, or the balance of a county excluding the area within any Federal or State American Indian reservation or tribal or individual trust land, having:

(A) A median income at or below 120 percent of the greater of the State non-metropolitan median income or the nationwide non-metropolitan median income and a minority population of 30 percent or greater; or

(B) A median income at or below 95 percent of the greater of the State non-metropolitan median income or nationwide non-metropolitan median income.

(ii) In New England, a whole county having the characteristics in paragraph (2)(i)(A) or (2)(i)(B) of this definition; a Federal or State American Indian reservation or tribal or individual trust land, having the characteristics in paragraph (2)(i)(A) or (2)(i)(B) of this definition; or the balance of a county, excluding any portion that is within any Federal or State American Indian reservation or tribal or individual trust land, or metropolitan area where the remainder has the characteristics in paragraph (2)(i)(A) or (2)(i)(B) of this definition.

(3) Any Federal or State American Indian reservation or tribal or individual trust land that includes land that is both within and outside of a metropolitan area and that is designated as an underserved area by HUD. In such cases, HUD will notify the GSEs as to applicability of other definitions and counting conventions.

* * * * *

3. Section 81.12 is amended as follows:

a. Paragraph (b) is amended by revising the last sentence; and

b. Paragraph (c) is revised, to read as follows:

§ 81.12 Low- and Moderate-Income Housing Goal.

* * * * *

(b) *Factors.* * * * A statement documenting HUD's considerations and findings with respect to these factors, entitled ''Departmental Considerations to Establish the Low- and Moderate-Income Housing Goal,'' was published in the **Federal Register** on [date of publication of final rule will be inserted].

(c) *Goals.* The annual goals for each GSE's purchases of mortgages on housing for low- and moderate-income families are:

(1) For calendar year 2000, 48 percent of the total number of dwelling units financed by that GSE's mortgage purchases unless otherwise adjusted by HUD in accordance with FHEFSSA;

(2) For each of the calendar years 2001–2003, 50 percent of the total number of dwelling units financed by that GSE's mortgage purchases in each of those years unless otherwise adjusted by HUD in accordance with FHEFSSA; and

(3) For calendar year 2004 and thereafter HUD shall establish annual goals. Pending establishment of goals for calendar year 2004 and thereafter, the annual goal for each of those calendar years shall be 50 percent of the total number of dwelling units financed by that GSE's mortgage purchases in each of those calendar years.

4. Section 81.13 is amended as follows:

a. Paragraph (b) is amended by revising the last sentence; and

b. Paragraph (c) is revised, to read as follows:

§ 81.13 Central Cities, Rural Areas, and Other Underserved Areas Housing Goal.

* * * * *

(b) *Factors.* * * * A statement documenting HUD's considerations and findings with respect to these factors, entitled ''Departmental Considerations to Establish the Central Cities, Rural Areas, and Other Underserved Areas Housing Goal,'' was published in the **Federal Register** on [date of publication of final rule will be inserted].

(c) *Goals.* The annual goals for each GSE's purchases of mortgages on housing located in central cities, rural areas, and other underserved areas are:

(1) For calendar year 2000, 29 percent of the total number of dwelling units financed by that GSE's mortgage purchases unless otherwise adjusted by HUD in accordance with FHEFSSA;

(2) For each of the calendar years 2001–2003, 31 percent of the total number of dwelling units financed by that GSE's mortgage purchases in each of those years unless otherwise adjusted by HUD in accordance with FHEFSSA; and

(3) For calendar year 2004 and thereafter HUD shall establish annual goals. Pending establishment of goals for calendar year 2004 and thereafter, the annual goal for each of those calendar years shall be 31 percent of the total number of dwelling units financed by that GSE's mortgage purchases in each of those calendar years.

* * * * *

5. Section 81.14 is amended as follows:

a. Paragraph (b) is amended by revising the last sentence;

b. Paragraph (c) is revised;

c. Paragraph (d) is amended by revising paragraph (d)(1)(i);

d. Paragraph (e) is amended by revising paragraphs (e)(2), (e)(3), and (e)(4);

e. Paragraph (f) is redesignated as paragraph (g) and the last sentence of the newly redesignated paragraph (g) is revised; and

f. A new paragraph (f) is added; to read as follows:

§ 81.14 Special Affordable Housing Goal.

* * * * *

(b) * * * A statement documenting the HUD's considerations and findings with respect to these factors, entitled ''Departmental Considerations to Establish the Special Affordable Housing Goal,'' was published in the **Federal Register** on [date of publication of final rule will be inserted].

(c) *Goals.* The annual goals for each GSE's purchases of mortgages on rental and owner-occupied housing meeting the then existing, unaddressed needs of and affordable to low-income families in low-income areas and very low-income families are:

(1) For calendar year 2000, 18 percent of the total number of dwelling units financed by that GSE's mortgage purchases unless otherwise adjusted by HUD in accordance with FHEFSSA. The goal shall include mortgage purchases financing dwelling units in multifamily housing totaling not less than 0.9 percent of the dollar volume of combined (single family and multifamily) mortgages purchased by the respective GSE in 1998 unless otherwise adjusted by HUD in accordance with FHEFSSA;

(2) For each of the calendar years 2001, 2002, and 2003, 20 percent of the total number of dwelling units financed by that GSE's mortgage purchases in

each of those years unless otherwise adjusted by HUD in accordance with FHEFSSA. The goal for each calendar year shall include mortgage purchases financing dwelling units in multifamily housing totaling not less than 1.0 percent of the dollar volume of combined (single family and multifamily) mortgages purchased by the respective GSE in 1998 unless otherwise adjusted by HUD in accordance with FHEFSSA; and

(3) For calendar year 2004 and thereafter HUD shall establish annual goals. Pending establishment of goals for calendar year 2004 and thereafter, the annual goal for each of those calendar years shall be 20 percent of the total number of dwelling units financed by that GSE's mortgage purchases in each of those calendar years. The goal for each such calendar year shall include mortgage purchases financing dwelling units in multifamily housing totaling not less than 1.0 percent of the dollar volume of combined (single family and multifamily) mortgages purchased by the respective GSE in 1998.

* * * * *

(d)(1) * * *

(i) 20 percent of the dwelling units in the particular multifamily property are affordable to especially low-income families; or

* * * * *

(e) * * *

* * * * *

(2) Mortgages under HUD's Home Equity Conversion Mortgage (''HECM'') Insurance Program, 12 U.S.C. 1715 z–20; mortgages guaranteed by the Rural Housing Services' Guaranteed Rural Housing Loan Program, 7 U.S.C. 1933; and mortgages on properties on tribal lands insured under FHA's Section 248 program, 12 U.S.C. 1715 z–13, or HUD's Section 184 program, 12 U.S.C. 1515 z–13a; meet the requirements of 12 U.S.C. 4563(b)(1)(A)(i) and (ii).

(3) HUD will give full credit toward achievement of the Special Affordable Housing Goal for the activities in 12 U.S.C. 4563(b)(1)(A), provided the GSE submits documentation to HUD that supports eligibility under 12 U.S.C. 4563(b)(1)(A) for HUD's approval.

(4)(i) For purposes of determining whether a seller meets the requirement in 12 U.S.C. 4563(b)(1)(B), a seller must currently operate on its own or actively participate in an on-going, discernible, active, and verifiable program directly targeted at the origination of new mortgage loans that qualify under the Special Affordable Housing Goal.

(ii) A seller's activities must evidence a current intention or plan to reinvest the proceeds of the sale into mortgages qualifying under the Special Affordable Housing Goal, with a current commitment of resources on the part of the seller to this purpose.

(iii) A seller's actions must evidence willingness to buy qualifying loans when these loans become available in the market as part of active, on-going, sustainable efforts to ensure that additional loans that meet the goal are originated.

(iv) Actively participating in such a program includes purchasing qualifying loans from a correspondent originator, including a lender or qualified housing group, that operates an on-going program resulting in the origination of loans that meet the requirements of the goal, has a history of delivering, and currently delivers, qualifying loans to the seller.

(v) The GSE must verify and monitor that the seller meets the requirements in paragraphs (e)(4)(i) through (e)(4)(iv) of this section and develop any necessary mechanisms to ensure compliance with the requirements, except as provided in paragraph (e)(4)(vi) of this section.

(vi) Where a seller's primary business is originating mortgages on housing that qualifies under this Special Affordable Housing Goal (*e.g.*, when such seller is an institution that is regularly in the business of mortgage lending; a BIF-insured or SAIF-insured depository institution; and subject to, and has received at least a satisfactory performance evaluation rating for at least the two most recent consecutive examinations under, the Community Reinvestment Act), such seller is presumed to meet the requirements in paragraphs (e)(4)(i) through (e)(4)(iv) of this section.

(vii) For a class or classes of institutions or organizations whose primary business is financing affordable housing mortgages, *e.g.*, State Housing Finance Agencies or Special Affordable Housing Loan Consortia, such classes of organizations or institutions are presumed to meet the requirements of paragraphs (e)(4)(i) through (e)(4)(iv) of this section. A determination that specific classes of institutions or organizations are primarily engaged in the business of financing affordable housing mortgages must be made in advance by HUD.

* * * * *

(f) *Partial credit activities.* Mortgages insured under HUD's Title I program, which includes property improvement and manufactured home loans, shall receive one-half credit toward the Special Affordable Housing Goal until such time as the Government National Mortgage Association fully implements a program to purchase and securitize Title I loans.

(g) *No credit activities.* * * * For purposes of this paragraph (g), ''mortgages or mortgage-backed securities portfolios'' includes mortgages retained by Fannie Mae or Freddie Mac and mortgages utilized to back mortgage-backed securities.

* * * * *

6. In § 81.15, paragraph (a) is revised, paragraph (d) is amended by adding a new sentence at the end, and paragraph (e) is amended by redesignating paragraph (e)(6) as (e)(7), and by adding a new paragraph (e)(6), to read as follows:

§ 81.15 General requirements.

(a) *Calculating the numerator and denominator.* Performance under each of the housing goals shall be measured using a fraction that is converted into a percentage.

(1) *The numerator.* The numerator of each fraction is the number of dwelling units financed by a GSE's mortgage purchases in a particular year that count toward achievement of the housing goal.

(2) *The denominator.* The denominator of each fraction is, for all mortgages purchased, the number of dwelling units that could count toward achievement of the goal under appropriate circumstances. The denominator shall not include GSE transactions or activities that are not mortgages or mortgage purchases as defined by HUD or transactions that are specifically excluded as ineligible under § 81.16(b).

(3) *Missing data or information.* When a GSE lacks sufficient data or information to determine whether the purchase of a mortgage originated after 1992 counts toward achievement of a particular housing goal, that mortgage purchase shall be included in the denominator for that housing goal, except under the circumstances described in paragraphs (d) and (e)(6) of this section.

* * * * *

(d) *Counting owner-occupied units.* * * * When the income of the mortgagors is not available to determine whether the purchase of a mortgage originated after 1992 counts toward achievement of the Low- and Moderate-Income Housing Goal or the Special Affordable Housing Goal, a GSE may exclude single- family owner-occupied units located in census tracts with median income less than or equal to area median income according to the most recent census from the denominator as well as the numerator, up to a ceiling of one percent of the total number of single-family owner-occupied dwelling units eligible to be counted toward the respective housing goal in the current year. Mortgage purchases in excess of the ceiling will be included in the denominator and excluded from the numerator.

(e) * * *

* * * * *

(6) *Income or Rent Data Unavailable.* (i) *Multifamily.* When neither the income of prospective or actual tenants of a dwelling unit nor actual or average rent data is available, a GSEs' performance with respect to such a unit may be evaluated with estimated rents based on market rental data, so long as the Department has reviewed and approved the data source and methodology for such estimated data. The GSE must identify such data as estimated data. When the application of estimated rents based on an approved market rental data source and methodology is not possible, and therefore the GSE lacks sufficient information to determine whether the purchase of a mortgage originated after 1992 counts toward the achievement of the Low- and Moderate-Income Housing Goal or the Special Affordable Housing Goal, a GSE may exclude units in multifamily properties from the denominator as well as the numerator in calculating performance under those goals.

(ii) *Rental units in 1–4 unit single family properties.* When neither the income of prospective or actual tenants of a rental unit in a 1–4 unit single family property nor actual or average rent data is available, and, therefore, the GSE lacks sufficient information to determine whether the purchase of a mortgage originated after 1992 counts toward achievement of the Low- and Moderate-Income Housing Goal or the Special Affordable Housing Goal, a GSE may exclude rental units in 1–4 unit single family properties from the denominator as well as the numerator in calculating performance under those goals.

* * * * *

7. Section 81.16 is amended as follows:

a. Paragraph (a) is revised;

b. Paragraph (b) is amended by revising paragraphs (b)(3) and (b)(9) and by adding a new paragraph (b)(10);

c. Paragraph (c) is amended by revising the heading, by adding introductory text, by revising paragraph (c)(6), and by adding new paragraphs (c)(9), (c)(10) and (c)(11); and

d. A new paragraph (d) is added; to read as follows:

§ 81.16 Special counting requirements.

(a) *General.* HUD shall determine whether a GSE shall receive full, partial, or no credit for a transaction toward achievement of any of the housing goals. In this determination, HUD will consider whether a transaction or activity of the GSE is substantially equivalent to a mortgage purchase and either creates a new market or adds liquidity to an existing market, provided however that such mortgage purchase actually fulfills the GSE's purposes and is in accordance with its Charter Act.

(b) * * *

* * * * *

(3) Purchases of non-conventional mortgages except:

(i) Where such mortgages are acquired under a risk-sharing arrangement with a Federal agency;

(ii) Mortgages under HUD's Home Equity Conversion Mortgage (''HECM'') Insurance Program, 12 U.S.C. 1715 z–20; mortgages guaranteed by the Rural Housing Services' Guaranteed Rural Housing Loan Program, 7 U.S.C. 1933; and mortgages on properties on tribal lands insured under FHA's Section 248 program, 12 U.S.C. 1715 z–13, or HUD's Section 184 program, 12 U.S.C. 1515 z–13a; or

(iii) Mortgages under other mortgage programs involving Federal guarantees, insurance or other Federal obligation where the Department determines in writing that the financing needs addressed by the particular mortgage program are not well served and that the mortgage purchases under such program should count under the housing goals, provided the GSE submits documentation to HUD that supports eligibility for HUD's approval.

* * * * *

(9) Single family mortgage refinancings that result from conversion of balloon notes to fully amortizing notes, if the GSE already owns or has an interest in the balloon note at the time conversion occurs. New purchases of balloon mortgages or mortgages for which the borrower has exercised a conversion option prior to purchase and/or guarantee by the GSE will be included in the numerator and denominator as appropriate in accordance with § 81.15.

(10) Any combination of (1) through (9) above.

(c) *Supplemental rules.* Subject to HUD's primary determination of whether a GSE shall receive full, partial, or no credit for a transaction toward achievement of any of the housing goals as provided in paragraph (a) of this section, the following supplemental rules apply:

* * * * *

(6) *Seasoned mortgages.* A GSE's purchase of a seasoned mortgage shall be treated as a mortgage purchase for purposes of these goals and shall be included in the numerator, as appropriate, and the denominator in calculating the GSE's performance under the housing goals, except where the GSE has already counted the mortgage under a housing goal applicable to 1993 or any subsequent year, or where the Department determines, based upon a written request by a GSE, that a seasoned mortgage or class of such mortgages should be excluded from the numerator and the denominator in order to further the purposes of the Special Affordable Housing Goal.

* * * * *

(9) *Expiring assistance contracts.* In accordance with 12 U.S.C. 4565(a)(5), actions that assist in maintaining the affordability of assisted units in eligible multifamily housing projects with expiring Section 8 contracts shall receive partial to full credit under the housing goals as determined by HUD. For purposes of the paragraph, ''actions'' include the restructuring or refinancing of mortgages, and credit enhancements or risk-sharing arrangements to modified or refinanced mortgages.

(10) *Bonus points.* The following transactions or activities, to the extent the units otherwise qualify for one or more of the housing goals, will receive bonus points toward the particular goal or goals, by receiving double weight in the numerator under a housing goal or goals and receiving single weight in the denominator for the housing goal or goals. Bonus points will not be awarded for the purposes of calculating performance under the special affordable housing multifamily subgoal included in § 81.14(c). All transactions or activities meeting the following criteria will qualify for bonus points even if a unit is missing affordability data and the missing affordability data is treated consistent with § 81.15(a)(3). Bonus points are available to the GSEs for purposes of determining housing goal performance through December 31, 2003. Beginning in calendar year 2004, bonus points are not available for goal performance counting purposes unless the Department extends their availability beyond December 31, 2003, for one or more types of activities and notifies the GSEs by letter of that determination.

(i) *Small multifamily properties.* HUD will assign double weight in the numerator under a housing goal or goals for each unit in small multifamily properties (5 to 50 units), provided, however, that bonus points will not be awarded for properties that are aggregated or disaggregated into 5–50 unit financing packages for the purpose of earning bonus points.

(ii) *Rental units in 2–4 unit owner-occupied properties.* HUD will assign double weight in the numerator under the housing goals for each unit in 2- to 4-unit owner-occupied properties, to the extent that the number of such units financed by mortgage purchases are in excess of 60 percent of the average number of units qualifying for the respective housing goal during the immediately preceding five years.

(11) *Temporary adjustment factor for Freddie Mac.* In determining Freddie Mac's performance on the Low- and Moderate-Income Housing Goal and the Special Affordable Housing Goal, HUD will count each qualifying unit in a property with more than 50 units as 1.2 units in calculating the numerator and as one unit in calculating the denominator, for the respective housing goal. HUD will apply this temporary adjustment factor for each calendar year from 2000 through 2003; for calendar years 2004 and thereafter, this temporary adjustment factor will no longer apply.

(d) *HUD review of transactions.* HUD will determine whether a class of transactions counts as a mortgage purchase under the housing goals. If a GSE is considering a class of transactions for purposes of counting under the housing goals, the GSE may provide HUD detailed information regarding the transactions for evaluation and determination in accordance with this section. In making its determination, HUD may also request and evaluate information from a GSE with regard to how the GSE believes the transactions should be counted. HUD will notify the GSE of its determination regarding the extent to which the class of transactions should count under the goals.

8. Section 81.17 is amended by adding a new paragraph (d), to read as follows:

§ 81.17 Affordability—Income level definitions—family size and income known (owner-occupied units, actual tenants, and prospective tenants).

* * * * *

(d) *Especially-low-income* means, in the case of rental units, where the income of actual or prospective tenants is available, income not in excess of the following percentages of area median income corresponding to the following family sizes:

Number of persons in family	Percentage of area median income
1	35
2	40
3	45
4	50
5 or more	(*)

*50% plus (4.0% multiplied by the number of persons in excess of 4).

9. Section 81.18 is amended by adding a new paragraph (d), to read as follows:

§ 81.18 Affordability—Income level definitions—family size not known (actual or prospective tenants).

(d) *For especially-low-income,* income of prospective tenants shall not exceed the following percentages of area median income with adjustments, depending on unit size:

Unit size	Percentage of area median income
Efficiency	35
1 bedroom	37.5
2 bedrooms	45
3 bedrooms or more	(*)

*52% plus (6.0% multiplied by the number of bedrooms in excess of 3).

10. In § 81.19, paragraph (d) is redesignated as paragraph (e), and a new paragraph (d) is added, to read as follows:

§ 81.19 Affordability—Rent level definitions—tenant income is not known.

* * * * *

(d) *For especially-low-income,* maximum affordable rents to count as housing for especially-low-income families shall not exceed the following percentages of area median income with adjustments, depending on unit size:

Unit size	Percentage of area median income
Efficiency	10.5
1 bedroom	11.25
2 bedrooms	13.5
3 bedrooms or more	(*)

*15.6% plus (1.8% multiplied by the number of bedrooms in excess of 3).

* * * * *

Dated: January 20, 2000.

William C. Apgar,

Assistant Secretary for Housing.

Note: The following Appendices will not appear in the Code of Federal Regulations.

Appendix A—Departmental Considerations to Establish The Low- and Moderate-Income Housing Goal

A. Introduction

1. Establishment of Goal

In establishing the Low- and Moderate-Income Housing Goals for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), collectively referred to as the Government-Sponsored Enterprises (GSEs), Section 1332 of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (12 U.S.C. 4562) (FHEFSSA) requires the Secretary to consider:

1. National housing needs;
2. Economic, housing, and demographic conditions;
3. The performance and effort of the enterprises toward achieving the Low-and Moderate-Income Housing Goal in previous years;
4. The size of the conventional mortgage market serving low-and moderate-income families relative to the size of the overall conventional mortgage market;
5. The ability of the enterprises to lead the industry in making mortgage credit available for low- and moderate-income families; and
6. The need to maintain the sound financial condition of the enterprises.

2. Underlying Data

In considering the statutory factors in establishing these goals, HUD relied on data from the 1995 American Housing Survey (AHS), the 1990 Census of Population and Housing, the 1991 Residential Finance Survey (RFS), the 1995 Property Owners and Managers Survey (POMS), other government reports, reports submitted in accordance with the Home Mortgage Disclosure Act (HMDA), and the GSEs. In order to measure performance toward achieving the Low- and Moderate-Income Housing Goal in previous years, HUD analyzed the loan-level data on all mortgages purchased by the GSEs for 1993–98 in accordance with the goal counting provisions established by the Department in the December 1995 rule (24 CFR part 81).

3. Conclusions Based on Consideration of the Factors

The discussion of the first two factors covers a range of topics on housing needs and economic and demographic trends that are important for understanding mortgage markets. Information is provided which describes the market environment in which the GSEs must operate (for example information on trends in refinancing activity) and is useful for gauging the reasonableness of specific levels of the Low- and Moderate-Income Housing Goal. In addition, the severe housing problems faced by lower-income families are discussed.

The third factor (past performance) and the fifth factor (ability of the GSEs to lead the industry) are also discussed in some detail in this Appendix. The fourth factor (size of the market) and the sixth factor (need to maintain the GSEs' sound financial condition) are mentioned only briefly in this

Appendix. Detailed analyses of the fourth factor and the sixth factor are contained in Appendix D and in the economic analysis of this proposed rule, respectively.

The factors are discussed in sections B through H of this appendix. Section I summarizes the findings and presents the Department's conclusions concerning the Low- and Moderate-Income Housing Goal. The consideration of the factors in this Appendix has led the Secretary to the following conclusions:

(i) Despite the record national homeownership rate of 66.3 percent in 1998, much lower rates prevailed for minorities, especially for African-American households (46.1 percent) and Hispanics (44.7 percent), and these lower rates are only partly accounted for by differences in income, age, and other socioeconomic factors.

(ii) Pervasive and widespread disparities in mortgage lending continued across the nation in 1997, when the loan denial rate was 10.2 percent for white mortgage applicants, but 23.3 percent for African Americans and 18.8 percent for Hispanics.[1]

(iii) Despite strong economic growth, low unemployment, the lowest mortgage rates in more than 30 years, and relatively stable home prices, there is clear and compelling evidence of deep and persistent housing problems for Americans with the lowest incomes. The number of very-low-income American households with ''worst case'' housing needs remains at an all-time high—5.3 million.[2]

(iv) Changing population demographics will result in a need for the primary and secondary mortgage markets to meet nontraditional credit needs, respond to diverse housing preferences and overcome information barriers that many immigrants face. In addition, market segments such as single-family rental properties, small multifamily properties, manufactured housing, and older inner city properties would benefit from the additional financing and pricing efficiencies of a more active secondary mortgage market.

(v) The Low- and Moderate-Income Housing Goals for both GSEs were 40 percent in 1996 and 42 percent in 1997. Fannie Mae surpassed these goals, with a performance of 45.6 percent in 1996, 45.7 percent in 1997 and 44.1 percent in 1998. Freddie Mac's performance of 41.1 percent in 1996, 42.6 percent in 1997 and 42.9 percent in 1998 narrowly exceeded these goals.

(vi) Several studies have shown that both Fannie Mae and Freddie Mac lag behind depository institutions and the overall conventional conforming market in providing affordable home loans to lower-income borrowers and underserved neighborhoods. Fannie Mae has made efforts to improve its performance. Freddie Mac, however, has made much less improvement, and therefore continues to fall behind Fannie Mae, depositories, and the overall market in serving lower-income and minority families and their neighborhoods. Thus, there is room for both GSEs (but particularly Freddie Mac) to improve their funding of single-family home mortgages for lower-income families and underserved communities.

(vii) The GSEs' presence in the goal-qualifying market is significantly less than their presence in the overall mortgage market. Specifically, HUD estimates that they accounted for 39 percent of all owner-occupied and rental units financed in the primary market in 1997, but only 30 percent of low- and moderate-income units financed. Their role was even lower for low- and moderate-income rental properties, where they accounted for 24 percent of low- and moderate-income multifamily units financed and only 13 percent of low- and moderate-income single-family rental units financed.

(viii) Other issues have also been raised about the GSEs' affordable lending performance. A large percentage of the lower-income loans purchased by the enterprises have relatively high down payments, which raises questions about whether the GSEs are adequately meeting the mortgage credit needs of lower-income families who do not have the cash to make a high down payment. Also, while single-family rental properties are an important source of low- and moderate-income rental housing, they represent only a small portion of the GSEs' business.

(ix) Freddie Mac has re-entered the multifamily market after withdrawing for a time in the early 1990s. Thus, concerns regarding Freddie Mac's multifamily capabilities no longer constrain their performance with regard to the Low- and Moderate-Income Housing Goal and for the Special Affordable Housing Goal to the same degree that prevailed at the time the Department issued its 1995 GSE regulations. However, Freddie Mac's multifamily presence remains proportionately lower than that of Fannie Mae. For example, units in multifamily properties accounted for 7.9 percent of Freddie Mac's mortgage purchases during 1996–1998, compared with 12.2 percent for Fannie Mae. Because a relatively large proportion of multifamily units qualify for the Low- and Moderate-Income Housing Goal and for the Special Affordable Housing Goal, Freddie Mac's weaker multifamily presence is a major factor contributing to its weaker overall performance on these two housing goals relative to Fannie Mae.

(x) The overall presence of both GSEs in the multifamily mortgage market falls short of their involvement in the single-family market. Specifically, the GSEs' purchases of 1997 originations have accounted for 49 percent of the owner market, but only 22 percent of the multifamily market. Further expansion of the presence of both GSEs in the multifamily market is needed in order for them to make significant progress in closing the gaps between the affordability of their mortgage purchases and that of the overall conventional market.

(xi) The GSEs have proceeded cautiously in expanding their multifamily purchases during the 1990s. Fannie Mae's multifamily lending has been described by Standard & Poor's as ''extremely conservative,'' and Freddie Mac has not experienced a single default on the multifamily mortgages it has purchased since 1993.[3] By the end of the 1998 calendar year, both GSEs' multifamily performance had improved to the point where multifamily delinquency rates were *less* than those in single-family.[4]

(xii) Because of the advantages conferred by Government sponsorship, the GSEs are in a unique position to provide leadership in addressing the excessive cost and difficulty in obtaining mortgage financing for underserved segments of the multifamily market, including small properties with 5–50 units and properties in need of rehabilitation.

B. Factor 1: National Housing Needs

This section reviews the general housing needs of low- and moderate-income families that exist today and are expected to continue in the near future. In so doing, the section focuses on the affordability problems of lower-income families and on racial disparities in homeownership and mortgage lending. It also notes some special problems, such as the need to rehabilitate our older urban housing stock.

1. Homeownership Gaps

Despite a record national homeownership rate, many Americans, including disproportionate numbers of racial and ethnic minorities, are shut out of homeownership opportunities. Although the national homeownership rate for all Americans was at an all-time high of 66.3 percent in 1998, the rate for minority households was less. The homeownership rate for African-American households was 46.1 percent. Similarly, just 44.7 percent of Hispanic households owned a home.

Importance of Homeownership. Homeownership is one of the most common forms of property ownership as well as savings.[5] In fact, home equity is the largest source of wealth for most Americans. Median net wealth for renters was less than five percent of the median net wealth for homeowners in 1995. Half of all homeowners in 1995 held more than half of their net wealth in the form of home equity. Even among low-income homeowners (household income less than $20,000), half held more than 70 percent of their wealth in home equity in 1995.[6] Thus a homeownership gap translates directly into a wealth gap.

Homeownership promotes social and community stability by increasing the

[1] Mortgage denial rates are based on 1997 HMDA data; data for selected manufactured housing lenders and subprime lenders are excluded from these comparisons.

[2] U.S. Department of Housing and Urban Development. *Waiting in Vain: Update on America's Rental Housing Crisis.* (March, 1999).

[3] ''Final Report of Standard & Poor's to the Office of Federal Housing Enterprise Oversight,'' February 3, 1997; Freddie Mac, *1998 Annual Report to Shareholders,* p. 6.

[4] Freddie Mac reported delinquency rates of 0.37 for multifamily and 0.50 percent for single-family in its *1998 Annual Report to Shareholders,* p. 30. Corresponding figures for Fannie Mae were 0.29 percent for multifamily and 0.58 percent for single-family *(1998 Annual Report to Shareholders,* p. 28).

[5] According to the National Association of Realtors, *Housing Market Will Change in New Millennium as Population Shifts,* (November 7, 1998), 45 percent of U.S. household wealth is in the form of home equity. Since 1968, home prices have increased each year, on average, at the rate of inflation plus up to two percentage points.

[6] Joint Center for Housing Studies of Harvard University. *State of the Nation's Housing 1997* (1997).

number of stakeholders and reducing disparities in the distributions of wealth and income. There is growing evidence that planning for and meeting the demands of homeownership may reinforce the qualities of responsibility and self-reliance. White and Green[7] provide empirical support for the association of homeownership with a more responsible, self-reliant citizenry. Both private and public benefits are increased to the extent that developing and reinforcing these qualities improve prospects for individual economic opportunities.

Barriers to Homeownership. Insufficient income, high debt burdens, and limited savings are obstacles to homeownership for younger families. As home prices skyrocketed during the late 1970s and early 1980s, real incomes also stagnated, with earnings growth particularly slow for blue collar and less educated workers. Through most of the 1980s, the combination of slow income growth and increasing rents made saving for home purchase more difficult, and relatively high interest rates required large fractions of family income for home mortgage payments. Thus, during that period, fewer households had the financial resources to meet down payment requirements, closing costs, and monthly mortgage payments.

Economic expansion and lower mortgage rates have substantially improved homeownership affordability during the 1990s. Many young, lower-income, and minority families who were closed out of the housing market during the 1980s have re-entered the housing market. However, many of these households still lack the financial resources and earning power to take advantage of today's homebuying opportunities. Several trends have contributed to the reduction in the real earnings of young adults without college education over the last 15 years, including technological changes that favor white-collar employment, losses of unionized manufacturing jobs, and wage pressures exerted by globalization. Fully 45 percent of the nation's population between the ages of 25 and 34 have no advanced education and are therefore at risk of being unable to afford homeownership.[8] African Americans and Hispanics, who have lower average levels of educational attainment than whites, are especially disadvantaged by the erosion in wages among less educated workers.

In addition to low income, high debts are a primary reason households cannot afford to purchase a home. According to a 1993 Census Bureau report, nearly 53 percent of renter families have both insufficient income and excessive debt problems that may cause difficulty in financing a home purchase.[9] High debt-to-income ratios frequently make potential borrowers ineligible for mortgages based on the underwriting criteria established in the conventional mortgage market.

An additional barrier to homeownership is the fear and uncertainty about the buying process and the risks of ownership. A study using focus groups with renters found that even among those whose financial status would make them capable of homeownership, many feel that the buying process was insurmountable because they feared rejection by the lender or being taken advantage of.[10] Also, many fear the obligations of ownership, because of the concerns about the risk of future deterioration of the house or the neighborhood.

Finally, discrimination in mortgage lending continues to be a barrier to homeownership. Disparities in treatment between borrowers of different races and neighborhoods of different racial makeup have been well documented. These disparities are discussed in the next section.

2. Disparities in Mortgage Financing

Disparities Between Borrowers of Different Races. Research based on Home Mortgage Disclosure Act (HMDA) data suggests pervasive and widespread disparities in mortgage lending across the Nation. For 1997, the denial rate for white mortgage applicants was 10.2 percent, while 23.3 percent of African-American and 18.8 percent of Hispanic applicants were denied. Even after controlling for income, the African-American denial rate was approximately twice that of white applicants. A major study by researchers at the Federal Reserve Bank of Boston found that mortgage denial rates remained substantially higher for minorities in 1991–93, even after controlling for indicators of credit risk.[11] African-American and Hispanic applicants in Boston with the same borrower and property characteristics as white applicants had a 17 percent denial rate, compared with the 11 percent denial rate experienced by whites. A subsequent study conducted at the Federal Reserve Bank of Chicago reports similar findings.[12]

Several possible explanations for these lending disparities have been suggested. The studies by the Boston and Chicago Federal Reserve Banks found that racial disparities cannot be explained by reported differences in creditworthiness. In other words, minorities are more likely to be denied than whites with similar credit characteristics, which suggests lender discrimination. In addition, loan officers, who may believe that race is correlated with credit risk, may use race as a screening device to save time, rather than devote effort to distinguishing the creditworthiness of the individual applicant.[13] This violates the Fair Housing Act.

Underwriting Rigidities. Underwriting rigidities may fail to accommodate creditworthy low-income or minority applicants. For example, under traditional underwriting procedures, applicants who have conscientiously paid rent and utility bills on time but have never used consumer credit would be penalized for having no credit record. Applicants who have remained steadily employed, but have changed jobs frequently, would also be penalized. Over the past few years, lenders, private mortgage insurers, and the GSEs have adjusted their underwriting guidelines to take into account these special circumstances of lower-income families. Many of the changes recently undertaken by the industry to expand homeownership have focused on finding alternative underwriting guidelines to establish creditworthiness that do not disadvantage creditworthy minority or low-income applicants.

However, because of the enhanced roles of credit scoring and automated underwriting in the mortgage origination process, it is unclear to what degree the reduced rigidity in industry standards will benefit borrowers who have been adversely impacted by the traditional guidelines. Some industry observers have expressed a concern that the greater flexibility in the industry's written underwriting guidelines may not be reflected in the numerical credit and mortgage scores which play a major role in the automated underwriting systems that the GSEs and others have developed. Thus lower-income and particularly minority loan applicants, who often have lower credit scores than other applicants, may be dependent on the willingness of lenders to take the time to look beyond such credit scores and consider any appropriate "mitigating factors," such as the timely payment of their bills, in the underwriting process. For example, there is a concern in the industry that a "FICO" score less than 620 means an automatic rejection of a loan application without further consideration of any such factors.[14] This could disproportionately affect minority applicants. More information on the distribution of credit scores and on the

[7] Michelle J. White, and Richard K. Green. "Measuring the Benefits of Homeowning: Effects on Children," *Journal of Urban Economics.* 41 (May 1997), pp. 441–61.

[8] Joint Center for Housing Studies of Harvard University. *State of the Nation's Housing 1998* (1998).

[9] Howard Savage and Peter Fronczek, *Who Can Afford to Buy A House in 1991?,* U.S. Bureau of the Census, Current Housing Reports H121/93–3, (July 1993), p. ix.

[10] Donald S. Bradley and Peter Zorn. "Fear of Homebuying: Why Financially Able Households May Avoid Ownership," *Secondary Mortgage Markets* (1996).

[11] Munnell, Alicia H., Geoffrey M. B. Tootell, Lynn E. Browne, and James McEneaney, "Mortgage Lending in Boston: Interpreting HMDA Data," *American Economic Review.* 86 (March 1996).

[12] William C. Hunter. "The Cultural Affinity Hypothesis and Mortgage Lending Decisions," WP–95–8, Federal Reserve Bank of Chicago, (1995). In addition, a study undertaken for HUD also found higher denial rates among FHA borrowers for minorities after controlling for credit risk. See Ann B. Schnare and Stuart A. Gabriel. "The Role of FHA in the Provision of Credit to Minorities," ICF Incorporated, Prepared for the U.S. Department of Housing and Urban Development, (April 25, 1994).

[13] See Charles W. Calomeris, Charles M. Kahn and Stanley D. Longhofer. "Housing Finance Intervention and Private Incentives: Helping Minorities and the Poor," *Journal of Money, Credit and Banking.* 26 (August 1994), pp. 634–74, for more discussion of this phenomenon, which is called "statistical discrimination."

[14] The FICO score, developed by Fair, Isaac and Company, is summary index of an individual's credit history. The FICO score is based on elements from the applicant's credit report, such as number of delinquencies in the past year, number of trade lines, and the amount owed on trade lines as compared to the available maximum credit limits. The FICO score is said to reflect the credit risk of the applicant and a score of 620 is often cited as a threshold between being an acceptable and an unacceptable credit risk.

effects of implementing automated underwriting systems is needed.[15]

Disparities Between Neighborhoods. Mortgage credit also appears to be less accessible in low-income and high-minority neighborhoods. As discussed in Appendix B, 1997 HMDA data show that mortgage denial rates are nearly twice as high in census tracts with low-income and/or high-minority composition, as in other tracts (23 percent versus 12 percent). Numerous studies have found that mortgage denial rates are higher in low-income census tracts, even accounting for other loan and borrower characteristics.[16] These geographic disparities can be the result of cost factors, such as the difficulty of appraising houses in these areas because of the paucity of previous sales of comparable homes. Sales of comparable homes may also be difficult to find due to the diversity of central city neighborhoods. The small loans prevalent in low-income areas are less profitable to lenders because up-front fees to loan originators are frequently based on a percentage of the loan amount, although the costs incurred are relatively fixed. Geographic disparities in mortgage lending and the issue of mortgage redlining are discussed further in Appendix B.

3. Affordability Problems and Worst Case Housing Needs

The severe problems faced by low-income homeowners and renters are documented in HUD's ''Worst Case Housing Needs'' report. This report, which is prepared biennially for Congress, is based on the American Housing Survey (AHS), conducted every two years by the Census Bureau for HUD. The latest report analyzes data from the 1995 AHS and focuses on the housing problems faced by low-income renters, but some data is also presented on families living in owner-occupied housing. In introducing a recent HUD report, Secretary Cuomo noted that it found ''clear and compelling evidence of deep and persistent housing problems for Americans with the lowest incomes.''[17]

The ''Worst Cases'' report measures three types of problems faced by homeowners and renters:

(i) Cost or rent burdens, where housing costs or rent exceed 50 percent of income (a ''severe burden'') or range from 31 percent to 50 percent of income (a ''moderate burden'');

(ii) The presence of physical problems involving plumbing, heating, maintenance, hallway, or the electrical system, which may lead to a classification of a residence as ''severely inadequate'' or ''moderately inadequate;'' and

(iii) Crowded housing, where there is more than one person per room in a residence.

The study reveals that in 1995, 5.3 million households had ''worst case'' housing needs, defined as housing costs greater than 50 percent of household income or severely inadequate housing among unassisted households. A preliminary HUD analysis of 1997 AHS data indicates that worst case needs have remained at or near this level.[18]

a. Problems Faced by Owners

Of the 63.5 million owner households in 1995, 4.9 million (8 percent) confronted a severe cost burden and another 8.1 million (13 percent) faced a moderate cost burden. There were 1.2 million households with severe physical problems and 0.9 million which were overcrowded. The report found that 25 percent of American homeowners faced at least one severe or moderate problem.

Not surprisingly, problems were most common among very low-income owners.[19] Nearly a third of these households faced a severe cost burden, and an additional 22 percent faced a moderate cost burden. And nearly 10 percent of these families lived in severely or moderately inadequate housing, while 3 percent faced overcrowding. Only 40 percent of very low-income owners reported no problems.

Over time the percentage of owners faced with severe or moderate physical problems has decreased, as has the portion living in overcrowded conditions. However, affordability problems have grown—the shares facing severe (moderate) cost burdens were only 3 percent (5 percent) in 1978, but rose to 5 percent (11 percent) in 1989 and 8 percent (13 percent) in 1995. The increase in affordability problems apparently reflects a rise in mortgage debt in the late 1980s and early 1990s, from 21 percent of homeowners' equity in 1983 to 36 percent in 1995.[20] As a result of the increased incidence of severe and moderate cost burdens, the share of owners reporting no problems fell from 84 percent in 1978 to 78 percent in 1989 and 75 percent in 1995.

b. Problems Faced by Renters

Problems of all three types listed above are more common among renters than among homeowners. In 1995 there were 6.2 million renter households (18 percent of all renters) who paid more than 50 percent of their income for rent.[21] Another 8 million faced a moderate rent burden, thus in total 40 percent of renters paid more than 30 percent of their income for rent.

Among very low-income renters, 70 percent faced an affordability problem, including 41 percent who paid more than half of their income in rent. More than one-third of renters with incomes between 51 percent and 80 percent of area median family income also paid more than 30 percent of their income for rent.

Affordability problems have increased over time among renters. The shares of renters with severe (moderate) rent burdens rose from 14 percent (18 percent) in 1978 to 15 percent (21 percent) in 1989 and 18 percent (22 percent) in 1995.

The share of families living in inadequate housing in 1995 was higher for renters (9 percent) than for owners (5 percent), as was the share living in overcrowded housing (5 percent for renters, but only 1 percent for owners). Crowding and inadequate housing were more common among lower-income renters, but among even the lowest income group, affordability was the dominant problem. The prevalence of inadequate and crowded rental housing has diminished over time, while affordability problems have grown.

Other problems faced by renters discussed in the ''Worst Cases'' report include the loss between 1993 and 1995 of 900,000 rental units affordable to very low-income families, the increase in ''worst case needs'' among working families between 1991 and 1995, and the shortage of units affordable to very low-income households (especially in the West).

The ''Worst Cases'' report presented analysis of 20-year trends in affordable housing units up through 1995, showing a steady decline in the number of such units. A recently-released HUD analysis of housing vacancy survey data reveals that this trend has continued since 1995, and that in the two years from 1996 to 1998 the number of units that rent for less than $300 (inflation-adjusted) declined by 19 percent.[22] The same study reports the median asking rent for new rental units as $726, or beyond the affordable range.

HUD's recent study on market trends includes also an analysis of trends in the Consumer Price Index from 1996 to 1998.[23] During this two-year period the price index for all items grew by 3.9 percent, but the price index for residential rent rose 6.2 percent. The same report also cites Bureau of Labor Statistics data showing that rents slightly outpaced income between 1995 and 1997 for the 20 percent of U.S. households with the lowest incomes. The report concludes that low-income renters are continuing to face an affordability crisis.

4. Other National Housing Needs

In addition to the broad housing needs discussed above, there are additional needs confronting specific sectors of the housing and mortgage markets. This section presents a brief discussion of three such areas and the roles that the GSEs play or might play in addressing the needs in these areas. Other

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[15] Section 3.b of this appendix provides a further discussion of automated underwriting.

[16] Robert B. Avery, Patricia E. Beeson and Mark E. Sniderman. *Understanding Mortgage Markets: Evidence from HMDA,* Working Paper Series 94–21. Federal Reserve Bank of Cleveland (December 1994).

[17] *Rental Housing Assistance—The Crisis Continues: The 1997 Report to Congress on Worst Case Housing Needs,* Department of Housing and Urban Development, Office of Policy Development and Research, (April 1998), p. i. All statistics in this subsection are taken from this report, except as noted.

[18] U.S. Department of Housing and Urban Development. *Waiting in Vain: Update on America's Rental Housing Crisis.* (March, 1999), section I.

[19] Very low-income households are defined in the report as those whose income, adjusted for family size, is less than 50 percent of area median income. This differs from the definition adopted by Congress in the GSE Act of 1992, which uses a cutoff of 60 percent and which does not adjust income for family size for owner-occupied dwelling units.

[20] Edward N. Wolff, ''Recent Trends in the Size Distribution of Household Wealth,'' *The Journal of Economic Perspectives,* 12(3), (Summer 1998), p. 137.

[21] Rent is measured in this report as gross rent, defined as contract rent plus the cost of any utilities which are not included in contract rent.

[22] ''Waiting in Vain'' (cited above), section III.2.

[23] *Ibid.,* section III.1.